

IMPROVING REMEDIES IN THE WTO DISPUTE SETTLEMENT SYSTEM

BY

KIL WON LEE

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Doctoral Committee:

Professor William J. Davey, Chair
Professor Nuno Garoupa
Professor Peter B. Maggs
Professor Thomas S. Ulen

ABSTRACT

The purpose of this research is to study the compliance problem that exists in the World Trade Organization (WTO) dispute settlement system. When a member state does not bring its trade policies into conformity with WTO obligations, the WTO dispute settlement system offers either compensation or retaliation as acceptable remedies to the aggrieved member states. However, there are inherent weaknesses to these remedies, leading some members to disregard them by maintaining their violations for lengthy periods, thereby resulting in ineffective compliance.

This dissertation assesses the problems associated with WTO dispute settlement remedies and considers possible improvements to them. First, I outline the applicable rules and procedures of WTO dispute settlement remedies in order to provide a general background for understanding this dissertation and examine their existing problems. I then attempt to clarify the purpose of WTO dispute settlement remedies, since knowing this purpose is an essential prerequisite for designing effective remedies. Finally, I offer suggestions to improve the remedies currently available through the WTO dispute settlement system.

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CHAPTER 1: INTRODUCTION

The increasing level of trade in the contemporary world has resulted in greater international economic interdependence among states. As a consequence, states perceive that a strong rule-based, multilateral institution regime may promote stability and cooperation in international economic relations. This belief led to the establishment of the World Trade Organization (WTO) in 1995, which replaced the old trading regime under the General Agreement on Tariffs and Trade (GATT).

In an effort to operate the WTO effectively, its members were cognizant of the need to fulfill their obligations and to have an effective instrument to deal with disputes. The successful negotiation of the Uruguay Round introduced the WTO Dispute Settlement Understanding (DSU). The DSU enhanced the legitimacy of the WTO by providing a rule-based, binding, and impartial mechanism through which members could resolve their disputes.¹ The DSU confers compulsory jurisdiction on the WTO Dispute Settlement Body (DSB), and is considered to be one of the most successful dispute settlement systems in public international law.

The WTO dispute settlement system has contributed significantly to the fair resolutions of international trade disputes. WTO members have generally respected the process and the decisions of the panels and the Appellate Body. The high volume of cases shows that members are willing to participate in the WTO dispute settlement system. One analysis of the first ten years of the WTO dispute settlement system indicates a successful

¹ Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, Legal Instruments – Results of the Uruguay Round, 33 I.L.M. 1125 (1994) [hereinafter DSU].

compliance rate of 83 per cent, which is higher than any other comparable international tribunal.²

The dispute settlement system set forth in the DSU is a central element to the operation of the WTO, providing increased security and predictability to the multilateral trading system.³ It is designed to moderate the behavior of WTO members by resolving disputes in an orderly fashion and ensuring rule enforcement. The DSB generally administers the DSU's implementation and surveillance procedure, which provides specific rules for remedies for non-compliance. Under the current system of remedies, if the complaining member prevails in a dispute, it may seek compensation from, or impose retaliation against, the violating member when the latter fails to comply with its WTO obligations.⁴ The general purpose of these remedies is meant to exert pressure on the violating member to bring its non-conforming measures into compliance.

However, a number of concerns have been raised with regard to these remedies. The primary concern is that they seem to be inadequate in order to bring good quality and timely compliance. As experience has shown, some members often exploit such inadequacies and disrespect the current system of remedies by maintaining their violations for a lengthy period. In this circumstance, those members injured by such violations may be reluctant to engage in future panel and Appellate Body proceedings, which would undermine the credibility of the WTO dispute settlement system.

² See William J. Davey, *The WTO Dispute Settlement System: The First Ten Years*, 8 J. Int'l Econ. L. 17, 46-48 (2005). Wilson also confirmed that 90 per cent of disputes found violations of WTO obligations and, in virtually all of those disputes, the violating member indicated "its intention to bring itself into compliance and the record indicates that in most cases it has already done so." Bruce Wilson, *Compliance by WTO Members with Adverse WTO Dispute Settlement Rulings*, 10 J. Int'l Econ. L. 397, 397 (2007).

³ See DSU art. 3.2.

⁴ "Retaliation" is a generic term for "suspension of concessions or other obligations" as used in the DSU and "countermeasures" as used in the Agreement on Subsidies and Countervailing Measures.

Therefore, this dissertation attempts to examine the problems of WTO dispute settlement remedies and explore ways to improve compliance in the WTO dispute settlement system.

The resources of this study are mainly academic writings and GATT/WTO documents including relevant legal texts, the adopted reports of panels and the Appellate Body, the decisions of arbitrators and the submitted papers of individual members.

The organization of this dissertation is as follows. In Chapter 2, I provide a general overview of WTO dispute settlement remedies. It explains the applicable rules and procedures for remedies and examines the current problems. The aim of this Chapter is to address the procedural stages of WTO remedies, thereby providing the general background necessary to understand this dissertation. I begin with a broad overview of remedies in the pre-WTO dispute settlement system, namely GATT, and examine how its rules and procedures have evolved and been incorporated into the WTO system. Then, I explore the rules and procedures for remedies in the WTO dispute settlement system and critically assess the problems with the current remedies in the following Section.

In Chapter 3, I examine the purpose behind WTO dispute settlement remedies. This examination is a prerequisite to designing effective remedies because the types of remedies to be recommended will differ according to their purpose. Currently, the purpose of remedies is not explicitly provided in any of the WTO agreements. This ambiguity seems to create uncertainty and confusion among WTO members, which has led to bitter controversies spanning over a decade. In this Chapter, I attempt to ascertain the purpose by looking at WTO dispute settlement remedies from historical, contractual and practical perspectives.

In Chapter 4, I propose potential improvements to the remedy scheme of the WTO dispute settlement system. To this end, my proposed remedies are specifically tailored to the purpose that was discussed in Chapter 3, and are measured aimed at solving, or at least minimizing, the problems explored in Chapter 2. In this Chapter, I also address ways to enhance both retaliation and compensation remedies.

In Chapter 5, I conclude with some comments.

CHAPTER 2: GENERAL OVERVIEW OF WTO DISPUTE SETTLEMENT

REMEDIES

This Chapter explains the applicable rules and procedures of WTO dispute settlement remedies and examines their current problems in order to provide a general background for understanding this dissertation. It is important to examine the rules and procedures, and evaluate their problems squarely prior to proposing effective and better solutions.

In Section I, I will begin with a general overview of remedies in the pre-WTO dispute settlement system, namely GATT, and examine how its rules and procedures have evolved and been incorporated into the WTO. In Section II, I will describe the rules and procedures of remedies in the WTO dispute settlement system and critically examine their existing problems, which can be viewed as a flaw in the international trade order. In Section III, I will conclude with some comments.

I. Remedies in the Pre-WTO Dispute Settlement System

There seems to be no clear lines of demarcation between WTO law and public international law in the sense that WTO law is widely recognized as a part of public international law.⁵ Especially, the dispute settlement procedure under the WTO has a common mechanism with the one under public international law with respect to remedies.

⁵ See Debra Steger, *The WTO Dispute Settlement System: Jurisdiction, Interpretation and Remedies*, in *Agreeing and Implementing the Doha Round of the WTO* 294, 294-307 (Harald Hohmann ed., 2008); John H. Jackson, *Sovereignty, the WTO and Changing Fundamentals of International Law* 48 (2006); Donald McRae, *The WTO in International Law: Tradition Continued or New Frontier?*, 3 J. Int'l Econ. L. 27, 27-28 (2000); Ernest-Ulrich Petersmann, *Dispute Settlement in International Economic Law – Lessons for the Strengthening International Dispute Settlement in Non-Economic Areas*, 2 J. Int'l Econ. L. 189, 189-248 (1999); David Palmeter & Petros C. Mavroidis, *The WTO Legal System: Source of Law*, 92 Am. J. Int'l L. 398, 413 (1998); John H. Jackson, *The World Trading System: Law and Policy of International Economic Relations* 25-28 (2d ed. 1997).

In this regard, it is very useful to analyze the remedies available under WTO law in reference to the notion of state responsibility under customary and public international law.⁶

The structure of WTO dispute settlement remedies can also be found in public international law. As explained by the International Law Commission's Draft Articles on Responsibility of States for Internationally Wrongful Acts (hereinafter the "ILC Draft"), international law recognizes three stages: cessation and non-repetition, reparation and countermeasures. The WTO follows these stages in the form of the withdrawal of inconsistent measures, compensation and retaliation. In detail, the WTO provides for the withdrawal of inconsistent measures as the primary remedy. If a violating member fails to withdraw its inconsistent measures, it may offer compensation as a secondary remedy. If neither remedy has been provided, a member state that prevails in a dispute may retaliate in the form of suspending concessions or other obligations as a last resort. The remedy of

⁶ The panel in *Korea – Government Procurement* confirmed that:

Article 3.2 of the DSU requires that we seek within the context of a particular dispute to clarify the existing provisions of the WTO agreements in accordance with customary rules of interpretation of public international law. However, the relationship of the WTO Agreements to customary international law is broader than this. Customary international law applies generally to the economic relations between the WTO Members. Such international law applies to the extent that the WTO treaty agreements do not 'contract out' from it. To put it another way, to the extent there is no conflict or inconsistency, or an expression in a covered WTO agreement that implies differently, we are of the view that the customary rules of international law apply to the WTO treaties and to the process of treaty formation under the WTO.

Panel Report, *Korea – Measures Affecting Government Procurement*, ¶ 7.96, WT/DS163/R (May 1, 2000). Despite the unclearness of the applicability of customary and public international law in the WTO, the remedies under WTO agreements are *lex specialis* in relation to the remedies under public international law. Article 55 of the International Law Commission's Draft Articles on Responsibility of States for Internationally Wrongful Acts recognizes the *lex specialis* principle which reflects the maxim *lex specialis derogate legi generali* ("special law prevails over general law"). See International Law Commission, Draft Articles on Responsibility of States for Internationally Wrongful Acts, art. 55, U.N. Doc. A/CN.4/L.602/Rev.1 (Jul. 26, 2001) [hereinafter ILC Draft]. For a general explanation of *lex specialis* in relation to public international law, see Bryan Mercurio & Mitali Tyagi, *Treaty Interpretation in WTO Dispute Settlement: The Outstanding Question of the Legality of Local Working Requirements*, 19 Minn. J. Int'l L. 275, 308-310 (2010); Santiago M. Villalpando, *Attribution of Conduct to the State: How the Rules of State Responsibility may be Applied within the WTO Dispute Settlement System*, 5 J. Int'l Econ. L. 393, 393-399 (2002); Joost Pauwelyn, *The Role of Public International Law in the WTO: How Far Can We Go?*, 95 Am. J. Int'l L. 535, 537-540 (2001).

the withdrawal of inconsistent measures in the WTO is in line with the remedy of cessation and non-repetition available under Article 30 of the ILC Draft, which provides that “[t]he State responsible for the internationally wrongful act is under an obligation: (a) to cease that act, if it is continuing; (b) to offer appropriate assurance and guarantees of non-repetition, if circumstances so require.” Similarly, the remedy of compensation in the WTO is in line with the remedy of reparation available under Article 31.1 of the Draft which provides that “[t]he responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.” Reparation is provided in the form of “restitution,” “compensation” and “satisfaction” under Article 34 of the Draft. Further, the remedy of retaliation in the WTO is in line with the remedy of countermeasures available under Article 49.1 of the Draft which provides that “[a]n injured State may only take countermeasures against a State which is responsible for an internationally wrongful act in order to induce that State to comply with its obligations” It is important to bear in mind that a comparative analysis of the two legal structures, the WTO and public international law, may facilitate a better understanding of WTO dispute settlement remedies.⁷

In this Section, I will begin with a general overview of remedies in the pre-WTO dispute settlement system and examine how their rules and procedures have evolved and been incorporated into the WTO dispute settlement system. It is important to discuss the pre-WTO dispute settlement system in order to gain a broader view of the remedies available in international trade disputes. Such discussion may also be helpful for

⁷ For a comparative analysis of the two legal structures, see Patricio Grane, *Remedies under WTO Law*, 4 J. Int’l Econ. L. 755, 756-763 (2001); James Cameron & Kevin R. Gray, *Principles of International Law in the WTO Dispute Settlement Body*, 50 Int’l & Comp. L.Q. 248, 292-293 (2001); Petros C. Mavroidis, *Remedies in the WTO Legal System: Between a Rock and a Hard Place*, 11 Eur. J. Int’l L. 763, 766-774 (2000).

understanding the historical background of WTO dispute settlement remedies.

1. Preparatory Work for GATT

The negotiations on GATT progressed simultaneously with the negotiations on the Charter for the International Trade Organization (ITO). In light of the view that problems with economic policy were one of the main causes of World War II, the international community was focused on building international economic institutions in the postwar period. In December 1945, the United States (US) issued a proposal for the establishment of the ITO, which was to be affiliated with the United Nations.⁸ In February 1946, the United Nations Economic and Social Council adopted a Resolution calling for a United Nations Conference on Trade and Employment for the purpose of creating the ITO and also established a Preparatory Committee to elaborate a draft of the Charter. In connection with its proposal, the US published the “Suggested Charter,” which became the basis for drafting the Charter at the First Session of the Preparatory Committee.⁹ The negotiations on the ITO Charter were carried out over a two-year period, from 1946 through 1948, in a series of meetings in London, New York, Geneva, and Havana, the last of which finally produced the “Havana Charter for an International Trade Organization.”¹⁰

⁸ See United States Department of State, *Proposals for Consideration by an International Conference on Trade and Employment*, in *Proposals for Expansions of World Trade and Employment*, Pub. No. 2411; Com. Pol’y Ser. 79 (1945). For a general overview of the ITO, see Robert E. Hudec, *The GATT Legal System and World Trade Diplomacy* (2d ed. 1990); Herbert Feis, *The Geneva Proposals for an International Trade Charter*, 2 Int’l Org. 39 (1948); Robert R. Wilson, *Proposed ITO Charter*, 41 Am. J. Int’l L. 879 (1947); Kenneth R. Wilson, *Geneva and the I.T.O.*, 2 Int’l J. 242 (1947).

⁹ United States Department of State, *Suggested Charter for an International Trade Organization of the United Nations*, Pub. No. 2598; Com. Pol’y Ser. 93 (1946). For the Report of the First Session, see U.N. Econ. & Soc. Council [ECOSOC], London, Oct. 15-Nov. 26, 1946, *Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*, U.N. Doc. E/PC/T/33 [hereinafter London Report].

¹⁰ See Final Act of the United Nations Conference on Trade and Employment: Havana Charter for an

While such negotiations were mainly aimed at establishing the ITO and producing the final draft of the Charter, states' interest in reducing tariffs and other trade restrictions increased rapidly. Hence, it was decided at the First Session that a Second Session should be convened to continue working on the Charter and to hold trade and tariff negotiations, and a Drafting Committee was appointed to draw up a full draft of the General Agreement.¹¹ The negotiations went on from April to October 1947 and, eventually, the final text of GATT and the schedules of tariff commitments were agreed upon by the GATT contracting parties.¹²

In this sense, GATT was influenced by the Draft Charter of the ITO in many respects. With regard to remedies, the introduction of a "consultation" procedure for the "satisfactory adjustment of the matter" (comparable to a "satisfactory solution through consultation" under Article XXII of GATT), the concept of "nullification or impairment," "appropriateness" and "suspension" emerged during the negotiations for drafting the Charter.¹³

Of course, this is not to suggest that the dispute settlement procedures and rules under GATT were identical to those found within the Draft Charter. The Draft Charter's rules were more elaborate and provided for its own dispute settlement procedures. Further, the

International Trade Organization, Mar. 24, 1948, U.N. Doc. E/Conf. 2/78, *available at* http://www.wto.org/english/docs_e/legal_e/havana_e.pdf. The Charter, however, never came into force due to the failure of the ratification by the United States. *See generally* William Diebold Jr., *The End of the ITO* (1952). For a critical view on the establishment of the ITO, see Huber Henderson, *A Criticism of the Havana Charter*, 39 *The Am. Econ. Rev.* 605 (1949).

¹¹ *See* U.N. Econ. & Soc. Council [ECOSOC], New York, Jan. 20-Feb. 25, 1947, *Report of the Drafting Committee of the Preparatory Committee of the United Nations Conference on Trade and Employment*, 65, U.N. Doc. E/PC/T/34 (Mar. 5, 1947) [hereinafter *New York Report*].

¹² Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, U.N. Sales No. 1947.II/10 (1947); General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter *GATT*].

¹³ *See* U.N. Econ. & Soc. Council [ECOSOC], Geneva, Apr. 10-Oct. 30, 1947, *Report of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*, 53, U.N. Doc. E/PC/T/186 (Sept. 10, 1947) [hereinafter *Geneva Report*]; *New York Report*, *supra* note 11, at 30; *London Report*, *supra* note 9, at 33.

Draft Charter permitted referrals of questions to the International Court of Justice for advisory opinions, an option that is not included in GATT.¹⁴ GATT only incorporated two rules from the Draft Charter, which were “consultations” under Article XXII and the concept of “nullification or impairment” under Article XXIII.

These differences aside, the Draft Charter generally has been considered as interpretative material for GATT since GATT was originally anticipated to be adopted into the institutional setting of the ITO. Although the Draft Charter differs from GATT in parts, it had a profound impact on the parties seeking to establish remedy procedures under GATT.

2. Remedies under GATT 1947

GATT did not provide for any specific remedy procedures in cases of member violations. As mentioned above, only a few paragraphs touched upon this subject, which were Articles XXII and XXIII.¹⁵ Much later, these Articles were supplemented by the Understanding on Notification, Consultation, Dispute Settlement and Surveillance of 28 November 1979 (hereinafter the “1979 Understanding”), and its Annex entitled, Agreed Description of the Customary Practice of GATT in the Field of Dispute Settlement (Article XXIII:2).¹⁶

¹⁴ See, e.g., Geneva Report, *supra* note 13, at 53-54. See also John H. Jackson, Restructuring the GATT System 58 (1990); Seymour J. Rubin, *The Judicial Review Problem in the International Trade Organization*, 63 Harv. L. Rev. 78, 81 & 93 (1949).

¹⁵ Mavroidis, *supra* note 7, at 774; Ernest-Ulrich Petersmann, *The GATT Dispute Settlement System and the Uruguay Negotiations on its Reform*, in Legal Issues in International Trade 53, 54 (Petar Sarcevic & Hans van Houtte eds., 1990). For a general overview on GATT remedies, see Pierre Pescatore, William J. Davey & Andreas F. Lowenfeld, *Handbook of WTO/GATT Dispute Settlement* (1997); William J. Davey, *Dispute Settlement in GATT*, 11 Fordham Int'l L.J. 51 (1987); Olivier Long, *Law and its Limitations in the GATT Multilateral Trade System* (1985).

¹⁶ Decision of the CONTRACTING PARTIES, *Understanding on Notification, Consultation, Dispute Settlement and Surveillance*, L/4907 (Nov. 28, 1979), GATT B.I.S.D. (26th Supp.) at 210 (1980) [hereinafter 1979 Understanding]. The legal status of an “Understanding” is quite unclear and it seems not

Article XXII provides for consultations in two stages: bilateral consultation between contracting parties and the involvement of the CONTRACTING PARTIES.¹⁷ Each contracting party may consult with each other “on any matter affecting the operation of this Agreement.” If parties are unable to find a satisfactory solution, the matter may be referred to the CONTRACTING PARTIES.

Article XXIII:1 provides a separate consultation procedure. It lists the types of disputes that could be brought to consultations. These types have been labeled violation complaints, non-violation complaints and situation complaints. In each instance, the complaint must allege nullification or impairment of benefits or impediment to the attainment of any objectives of the Agreement. If there is no satisfactory adjustment to an Article XXIII:1 dispute, the matter may be referred to the CONTRACTING PARTIES under Article XXIII:2. In such a case, the CONTRACTING PARTIES are to promptly investigate the matter and make appropriate recommendations or give a ruling on the matter. The CONTRACTING PARTIES are also authorized to suspend concessions and other obligations as retaliatory actions if circumstances are serious enough.

As a supplement to Articles XXII and XXIII, Paragraph 4 of the Annex to the 1979 Understanding established a fairly precise procedure with respect to remedies. It provides that the first objective of the CONTRACTING PARTIES is to secure the withdrawal of the inconsistent measure and that compensation should be resorted to as a temporary measure only in instances when compliance is impracticable. Further, retaliation is

to be a stand-alone treaty. However, it may be adopted under Article XXV:1 for the purpose of facilitating and furthering the operation and the objectives of the General Agreement. *See* John H. Jackson, *The World Trading System* 96 (1989).

¹⁷ The term “CONTRACTING PARTIES” in capital letters is defined under Article XXV:1 of GATT: “[w]herever reference is made in this Agreement to the contracting parties acting jointly they are designated as the CONTRACTING PARTIES.” Each contracting party is a member of the CONTRACTING PARTIES where each party is entitled to have one vote at all meetings of the CONTRACTING PARTIES.

allowed as a last resort subject to the authorization of the CONTRACTING PARTIES. In the following, I will describe each of these remedies in greater detail, respectively.

2.1. Withdrawal of Inconsistent Measures

Parties to a dispute normally seek a mutually satisfactory and acceptable solution through consultation.¹⁸ However, when a mutually agreed solution is not achieved, the first objective of the CONTRACTING PARTIES is “to secure the withdrawal of the measures concerned if these are found to be inconsistent with the General Agreement.”¹⁹ In *Uruguayan Recourse to Article XXIII*, the panel noted that where a measure concerned was in contradiction with the General Agreement, it in all cases would recommend that “the measure in question be removed.”²⁰ Thus, when a panel finds a violation of GATT, it recommends the “cessation and non-repetition” of the violation, which seems to be in accordance with the primary remedy under public international law.

In *Norway – Trondheim Toll Equipment*, the panel found Norway to be in violation of its GATT obligations when it subsidized a Norwegian company that was constructing a toll ring system in the city of Trondheim.²¹ It asked Norway to acknowledge the

¹⁸ See GATT art. XXII:2.

¹⁹ Annex to the 1979 Understanding, ¶ 4. Paragraph I.1 of the Decision of 12 April 1989 on Improvements to the GATT Dispute Settlement Rules and Procedures also provides that “[p]rompt compliance with recommendations or rulings of the CONTRACTING PARTIES under Article XXIII is essential in order to ensure effective resolution of disputes to the benefit of all contracting parties.” See Decision of the CONTRACTING PARTIES, *Improvements to the GATT Dispute Settlement Rules and Procedures*, ¶ I.1, L/6489 (Apr. 12, 1989), GATT B.I.S.D. (36th Supp.) at 61, 67 (1990) [hereinafter 1989 Decision]. The Report of the Review Session Working Party also noted that “the first objective, if the CONTRACTING PARTIES decided, in the event of a complaint under Article XXIII, that certain measures were inconsistent with provisions of the Agreement, should be to secure the withdrawal of the measures.” Review Report of the Working Parties, *Reports Relating to the Review of the Agreement on Organization and Functional Questions*, ¶ 64, L/327 (Feb. 28 & Mar. 5 & 7, 1955), GATT B.I.S.D. (3rd Supp.) at 231, 251 (1955) [hereinafter 1955 Report].

²⁰ Report of the Panel, *Uruguayan Recourse to Article XXIII*, ¶ 20, L/1923 (Nov. 16, 1962), GATT B.I.S.D. (11th Supp.) at 95, 101 (1963) [hereinafter *Uruguayan Recourse to Article XXIII*].

²¹ See generally Report of the Panel, *Norway – Procurement of Toll Collection Equipment for the City of*

illegality of the subsidies and to provide guarantees for non-repetition. However, the panel did not force Norway to make any revocations or reimbursements, nor did it require Norway to provide any reparations for the harm suffered by the complaining party, the US. Although it mentioned that one way for Norway to bring “the Trondheim procurement into line with its obligations under the Agreement would be by annulling the contract and recommencing the procurement process,” it concluded that such recommendations would be beyond the customary practice in dispute settlement under the GATT system and that they would be disproportionate in this case.²²

GATT provides a time frame for the implementation of panel recommendations. This recognizes the time it may take a member state to make the necessary changes to its domestic law in implementing the recommendations. Paragraph I.2 of the 1989 Decision provides that “[i]f it is impracticable to comply immediately with the recommendations

Trondheim, GPR.DS2/R (Apr. 28, 1992), GATT B.I.S.D. (40th Supp.) at 319 (1993).

²² *Id.* ¶ 4.17. However, there were seven unusual cases dealing with anti-dumping and countervailing duties where retroactive remedies were provided. For adopted reports, see Report of the Panel, *New Zealand – Imports of Electrical Transformers from Finland*, L/5814 (Jul. 18, 1985), GATT B.I.S.D. (32nd Supp.) at 55 (1986); Report of the Panel, *United States – Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada*, DS7/R (Jul. 11, 1991), GATT B.I.S.D. (38th Supp.) at 30 (1992); Report of the Panel, *United States – Measures Affecting Imports of Softwood Lumber from Canada*, SCM/162 (Oct. 27, 1993), GATT B.I.S.D. (40th Supp.) at 358 (1995). For un-adopted reports, see Report of the Panel, *Canada – Imposition of Countervailing Duties on Imports of Manufacturing Beef from the EEC*, SCM/85 (Oct. 13, 1987); Report of the Panel, *United States – Imposition of Anti-Dumping Duties on Import of Seamless Stainless Steel Hollow Products from Sweden*, ADP/47 (Aug. 20, 1990); Report of the Panel, *United States – Anti-Dumping Duties on Gray Portland Cement and Cement Clinker from Mexico*, ADP/82 (Sept. 7, 1992); Report of the Panel, *United States – Anti-Dumping Duties on Imports of Stainless Steel Plate from Sweden*, ADP/117 (Feb. 24, 1994). However, the use of retroactive relief seems to be limited to anti-dumping and countervailing duties practice. Hudec argues that these cases are merely an exception to ordinary GATT practice of denying reimbursement. See Robert E. Hudec, *Broadening the Scope of Remedies in the WTO Dispute Settlement*, in *Improving WTO Dispute Settlement Procedures: Issues & Lessons from the Practice of Other International Courts & Tribunals* 369, 379 & 382 (Friedl Weiss ed., 2000). The decision of the CONTRACTING PARTIES in *Netherlands Measures of Suspension* supports his argument by concluding that retroactive remedies would be inappropriate and a departure from GATT practice. Furthermore, it stated that such remedies were not within customary practice under GATT and would go beyond the terms of reference of the panel. See *Netherlands Measures of Suspension of Obligations to the United States* (Nov. 8, 1952), GATT B.I.S.D. (1st Supp.) at 32 (1953) [hereinafter *Netherlands Measures of Suspension*]. For more on the issue of retroactive remedies in GATT, see Mavroidis, *supra* note 7, at 775; Grane, *supra* note 7, at 765; Robert E. Hudec, *Enforcing International Trade Law: the Evolution of the Modern GATT Legal System* 253-254 (1993).

or rulings, the contracting party concerned shall have a reasonable period of time in which to do so.”²³ For instance, the US government requested a reasonable period of time to repeal its domestic law, Section 104 of the United States Defense Production Act.²⁴

2.2. Compensation

There is no specific provision on compensation under the General Agreement. Only the 1955 Report and the Annex to the 1979 Understanding note the provision of compensation. The term “compensation” first emerged in the 1955 Report. It provides that “the alternative of providing compensation for damage suffered should be resorted to only if the immediate withdrawal of the measures was impracticable and only as a temporary measure pending the withdrawal of the measures which were inconsistent with the Agreement.”²⁵ Paragraph 4 of the Annex to the 1979 Understanding contains precisely the same sentence. The important implication here is that compensation is a remedy that is available only for as long as the inconsistent measures have not been withdrawn. Thus, only a member state’s failure to comply with panel recommendations would lead to the provision of compensation.

Although the term “compensation” has not been defined, it is considered in practice to be the granting of concessions in the form of greater market access, i.e., tariff reduction, by the violating party. It is, to a certain extent, to return the disputing contracting parties

²³ Paragraph 22 of the 1979 Understanding also provides that recommendations by the CONTRACTING PARTIES are to be implemented “within a reasonable period of time.”

²⁴ See CONTRACTING PARTIES, *Sixth Session, Summary Record of the Twenty-Seventh Meeting, Held at the Palais des Nations, Geneva*, 8, GATT/CP.6/SR.27 (Oct. 30, 1951). In GATT practice, however, the Council has often not specified the “reasonable period of time.” See Petersmann, *supra* note 15, at 91.

²⁵ The 1955 Report, *supra* note 19, ¶ 64.

to a mutual balance of tariff concessions.²⁶ It is left to the contracting parties to determine compensatory concessions. Thus, it is a matter agreed upon by the parties concerned, and the panels do not adjudicate on specific matters of compensation.²⁷

In practice, the panels declined to recommend or suggest compensation. In *EEC – Dessert Apples*, Chile argued that it was entitled to compensation due to the distortion of the competitive relationship on the basis of losses and lost opportunities to Chilean exporters.²⁸ Although the panel recognized the possibility of compensation by recalling the 1965 Note and the 1979 Understanding, it noted that there was no provision in GATT requiring the parties to provide compensation. As such, it declined to suggest compensation.²⁹ In *US – Sugar Waiver*, the European Economic Community (EEC) argued that the US restriction on imports on sugar-containing products was inconsistent with Article XI. It further argued that it was entitled to compensation due to nullified or impaired benefits from the US restriction. By referring to paragraph 4 of the Annex to the 1979 Understanding, the panel relied on the same reasoning as *EEC – Dessert Apples*, finding that “[a] contracting party might, in conformity with that provision, choose to grant compensation to forestall a request for an authorization of retaliatory measures

²⁶ Compensation seems to accord in part with the notion of “reparation” under public international law. The purpose of reparation is to eliminate the consequences of the illegal act and restore the situation to the *status quo ante*. It is well pronounced in *Chorzow Factory* that “reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.” *Factory at Chorzow* (Ger. v. Pol.), Merits, 1928 P.C.I.J. (ser. A) No. 17, at 47 (Sept. 13). Compensation in GATT, as noted previously, is prospective restoration of the *status quo ante*; it does not compensate for damages caused by the breach.

²⁷ Committee on Trade and Development, *Note by the Secretariat: Compensation to Less-Developed Contracting Parties for Loss of Trading Opportunities Resulting from the Application of Residual Restrictions*, ¶ 10, COM.TD/5 (Mar. 2, 1965) [hereinafter 1965 Note].

²⁸ Report of the Panel, *European Economic Community – Restrictions on Imports of Dessert Apples – Complaint by Chile*, ¶¶ 10.1-10.4, L/6491 (Jun. 22, 1989), GATT B.I.S.D. (36th Supp.) at 93, 120-121 (1990) [hereinafter *EEC – Dessert Apples*].

²⁹ *Id.* ¶¶ 12.34-12.36.

under Art. XXIII:2, but the Understanding does not oblige it to do so.”³⁰ Hence, in practice, the CONTRACTING PARTIES or panels declined to provide compensation. It was optional available to the parties in the dispute to offer and determine compensation by mutual agreement.

2.3. Retaliation

2.3.1. Authorization of Retaliation

Under GATT practice, retaliation was to be taken as a last resort in the form of suspension of concessions or other obligations and “at the discretion of the CONTRACTING PARTIES in defined circumstances.”³¹ The CONTRACTING PARTIES may authorize retaliation when a violating party does not comply with a panel recommendation within a reasonable period of time. In other words, retaliation should not be authorized unless compliance has not been achieved within such a period.³²

The purpose of retaliation was to maintain a mutual balance of concessions and obligations.³³ Thus, it was to offset the reduction in benefits resulting from non-

³⁰ Report of the Panel, *United States – Restrictions on the Importation of Sugar and Sugar Containing Products Applied under the 1955 Waiver and under the Headnote to the Schedule of Tariff Concessions*, ¶ 5.22, L/6631 (Nov. 7, 1990), GATT B.I.S.D. (37th Supp.) at 228, 262 (1991) [hereinafter *US – Sugar Waiver*].

³¹ See *Uruguayan Recourse to Article XXIII*, *supra* note 20, ¶ 11.

³² In *French Import Restrictions*, the panel found that the French import restrictions were inconsistent with Article XI and suggested “that the CONTRACTING PARTIES recommended to the United States Government that it refrain, for a reasonable period, from exercising its right, under the procedure of paragraph 2 of Article XXIII, to propose suspension of the application of equivalent obligation or concessions.” Report of the Panel, *French Import Restriction*, ¶ 7, L/1921 (Nov. 14, 1962), GATT B.I.S.D. (11th Supp.) at 94, 95 (1963) [hereinafter *French Import Restriction*].

³³ See John H. Jackson, *World Trade and the Law of GATT* 177 (1969). See also Sungjoon Cho, *the Nature of Remedies in International Trade Law*, 65 U. Pitt. L. Rev. 763, 766-767 (2004) (Arguing that the form of remedies under GATT 1947 was “mainly a reciprocal tariff reduction mechanism.” He further notes that it was intended to “restore the delicate balance of interests that contracting parties had labored to establish through a series of tariff reductions”); Brendan P. McGivern, *Seeking Compliance with WTO Rulings: Theory, Practice and Alternatives*, 36 Int’l Law. 141, 144 (2002) (Arguing that one of the primary purposes of retaliation under GATT was to restore balance of concessions between the complaining and defending member); U.N. Econ. & Soc. Council [ECOSOC], *Verbatim Report of the Second Session of the*

compliance. This notion was based on the reciprocity principle, one of the fundamental principles underlying GATT, that “each government’s obligations are given in exchange for the obligations of the other parties to the agreement” in order to liberalize trade.³⁴ In addition, another purpose was to prevent contracting parties from unilateral reprisals which were often unnecessary and excessive. Hence, the objective was to provide multilaterally authorized retaliation.³⁵

There was only one instance where retaliation was authorized under GATT. In *Netherlands Measures of Suspension*, the US did not remove its import restrictions, which were found to be inconsistent to the General Agreement. In response, the CONTRACTING PARTIES authorized the Netherlands to “suspend the application to the United States of their obligation under the General Agreement to the extent necessary to allow the Netherlands Government to impose an upper limit of 60,000 metric tons on imports of wheat flour from the United States during the calendar year 1953.”³⁶ However, the Netherlands did not retaliate against the US. After a number of years, a compromise was apparently reached as the US relaxed its quotas on Edam and Gouda cheese and the Netherlands no longer requested the extension of its authority to retaliate.³⁷

Preparatory Committee of the United Nations Conference on Trade and Employment, 5, U.N. Doc. E/PC/T/A/PV/6 (Jun. 2, 1947) (Noting that “[w]hat we have really provided, in the last analysis, is not that retaliation shall be invited or sanctions invoked, but that a balance of interests, once established, shall be maintained”).

³⁴ Long, *supra* note 15, at 10-11.

³⁵ See Ernst-Ulrich Petersmann, *The GATT/WTO Dispute Settlement System: International Law, International Organizations and Dispute Settlement* 82 (1997).

³⁶ Report to the CONTRACTING PARTIES, *Working Party 8 on Netherlands Action under Article XXIII:2*, ¶ 7, L/61 (Nov. 7, 1952) [hereinafter *Working Party 8 on Netherlands Action*]; CONTRACTING PARTIES, *United States Import Restrictions on Dairy Products, Resolution of 5 November 1954*, L/280 (Nov. 11, 1954).

³⁷ Naboth van den Broek, *Power Paradoxes in Enforcement and Implementation of World Trade Organization Dispute Settlement Reports*, 37 J. World Trade 127, 144 (2003). For a detailed explanation on this case, see Hudec, *supra* note 8, at 191-198.

2.3.2. Requirements

In order for the CONTRACTING PARTIES to authorize retaliation, two essential requirements must be met. These requirements are explicitly set forth in Article XXIII:2. Under Article XXIII:2, retaliation is permissible only “if the CONTRACTING PARTIES consider that the circumstances are serious enough to justify such action” and “authorize a contracting party or parties to suspend the application to any other contracting party or parties of such concessions or other obligations under this Agreement as they determine to be appropriate in the circumstances.” Put simply, retaliation is authorized only (1) if the circumstances were “serious enough” and (2) to the extent that it is “appropriate” in the circumstances.

2.3.2.1. Serious Enough

The “serious enough” requirement consists of two elements. First, the circumstances are “serious enough” when the party concerned has exhausted all other appropriate remedies and, thus, retaliation is the only means to prevent nullification or restore the *status quo ante*. The 1955 Report notes as follows:

[I]t was, therefore, desirable that resort should be had to retaliatory action only when all other possibilities had been explored.

The requirement in paragraph 2 of . . . Article XXIII that the circumstances must be “serious enough” limits the possibility of authorizing a contracting party or parties to take appropriate retaliatory action to cases where endeavours to solve the problem through the withdrawal of the measures causing the damage, the substitution of other concessions, or some other appropriate action have not proved to be possible, and where there is considered to be a substantial justification for retaliatory action, as in cases in which such authorization appears to be the only means either of preventing serious economic consequences to the country for which a benefit

has been nullified or impaired, or the only means of restoring the original situation.³⁸

Second, the “serious enough” requirement is limited to cases where a benefit is being nullified or impaired. It seems quite clear from the language in Paragraph 5 of the Annex to the 1979 Understanding: “contracting parties have had recourse to Article XXIII only when in their view a benefit accruing to them under the General Agreement was being nullified or impaired.” In *Uruguayan Recourse to Article XXIII*, the panel also noted that “the situation must be serious enough limits the applicability of the provision to cases where there is nullification or impairment; it would at any rate be difficult to conceive a situation in which the suspension of concessions or obligations could be appropriate where nullification or impairment was not involved.”³⁹ Thus, the mere fact that the attainment of any objective of GATT was being impeded would apparently fail to meet the “serious enough” requirement.

2.3.2.2. Appropriateness Standard

The appropriateness standard is comprised of three elements. Two of these elements were mentioned by the Working Party in *Netherlands Measures of Suspension*. It considered (1) “whether, in the circumstances, the proposed measure was appropriate in

³⁸ The 1955 Report, *supra* note 19, ¶¶ 62-63.

³⁹ *Uruguayan Recourse to Article XXIII*, *supra* note 20, ¶ 13. See also Report of the Panel, Conciliation, *Uruguayan Recourse to Article XXIII*, ¶ 2, L/2074 (Mar. 3, 1965), GATT B.I.S.D. (13th Supp.) at 35, 36 (1966). The panel recommended as follows:

These contracting parties concerned were asked to report by 1 March 1963 on action taken to comply with the recommendations or on any other satisfactory adjustment, such as the provision of suitable concessions acceptable to Uruguay. It was provided that, if by that date any recommendation has not been carried out and no satisfactory adjustment has been effected, the circumstances will be deemed to be “serious enough” to justify action under the penultimate sentence of paragraph 2 of Article XXIII and Uruguay will be entitled immediately to request authority to suspend obligations or concessions.

character,” and (2) “whether the extent of retaliation was reasonable in light of the impairment suffered.”⁴⁰ With respect to the reasonableness of retaliation in light of the impairment suffered, the Working Party further recognized that although “it was appropriate to consider calculations of the trade affected by the measures and countermeasures in question, it was aware that a pure statistical test would not . . . be sufficient and that it would also be necessary to consider the broader economic elements entering into the assessment of the impairment suffered.”⁴¹

The third element requires retaliation to have an inducement effect for compliance. In the 1952 Meeting, the Working Party made it clear that the determination on the level of retaliation “would be more appropriate in the sense best calculated to achieve the purpose for which the measure was taken, i.e.,] the removal of the [inconsistent measures].”⁴²

Overall, retaliation meets the appropriateness standard when (1) it is appropriate in character, (2) the level of retaliation is reasonable in light of the impairment suffered, having regard to the value of trade affected and the broader economic elements, and (3) it achieves the eventual solution in accordance with the purpose of GATT.

The appropriateness standard is deemed to require some level of equivalence between the nullification or impairment and the retaliation.⁴³ However, it does not call for exact equivalence. Mathur, the GATT Deputy Director-General, emphasized that:

Article XXIII:2, unlike Article XXVIII, did not speak about equivalent concessions and therefore, it was not really a question of authorizing the

⁴⁰ *Working Party 8 on Netherlands Action*, *supra* note 36, ¶ 3.

⁴¹ *Id.* ¶ 4.

⁴² CONTRACTING PARTIES, *Summary Record of the Seventeenth Meeting, Held at the Palais des Nations, Geneva*, ¶ 1, SR.7/17 (Nov. 18, 1952).

⁴³ In *Netherlands Measures of Suspension*, the Working Party examined the appropriateness of the retaliation “having regard to its equivalence to the impairment suffered by the Netherlands as a result of the United States restrictions.” *Working Party 8 on Netherlands Action*, *supra* note 36, ¶ 2.

withdrawal of equivalent concessions as such. That was why the Secretariat had pointed out that Article XXIII did not require that amount of retaliation should be equivalent, and that the CONTRACTING PARTIES might wish to determine what other factors to take into account in examining the appropriateness of the proposed retaliatory measure.⁴⁴

Thus, the term appropriate is considered to be a less strict term than equivalence, which may, in fact, provide some flexibility in determining the level of retaliation.

2.4. Multilateral Surveillance of Implementation

Paragraph 22 of the 1979 Understanding provides that the “CONTRACTING PARTIES shall keep under surveillance any matter on which they have made recommendations or given rulings.” It further reads that “[i]f the CONTRACTING PARTIES’ recommendations are not implemented within a reasonable period of time, the contracting party bringing the case may ask the CONTRACTING PARTIES to make suitable efforts with a view to finding an appropriate solution.”

The Ministerial Declaration of 29 November 1982, Decision on Dispute Settlement (hereinafter the “1982 Declaration”), specifies the role of the Council on surveillance. Under Paragraph (viii) of the 1982 Declaration, in furtherance of paragraph 22 of the 1979 Understanding, it provides that “the Council shall periodically review the action taken pursuant to such recommendations. The contracting party, to which such a recommendation has been addressed, shall report within a reasonable specified period on action taken or on its reasons for not implementing the recommendation or ruling by the CONTRACTING PARTIES.”⁴⁵ In addition, unless the Council decides otherwise, “the

⁴⁴ GATT Council, *Minutes of Meeting, Held in the Centre William Rappard on 22 September 1988*, 19, C/M/224 (Oct. 17, 1988).

⁴⁵ Paragraph I.2 of the 1989 Decision also provides that the “contracting party concerned shall inform the

issue of implementation of the recommendations or rulings shall be on the agenda until the issue is resolved. At least ten days prior to each such Council meeting, the contracting party concerned shall provide the Council with a status report in writing of its [implementation] progress”⁴⁶

The purpose of surveillance is to secure the withdrawal of the measures concerned, if they are found to be inconsistent with GATT. This mechanism has promoted “rule integrity” in the GATT system.⁴⁷

2.5. Problems of GATT Dispute Settlement Remedies

Overall, the primary remedy under the GATT procedure is to secure the withdrawal of the inconsistent measures. If the immediate withdrawal is impracticable, compensation may be resorted to as a temporary measure upon the parties’ agreement. And if the inconsistent measures have not been removed within a reasonable period of time, as a last resort, the CONTRACTING PARTIES may authorize retaliation.

However, problems persisted in implementing these remedies. First, some parties retained legal authority not to obey their GATT obligations. This situation would arise when a losing party blocked the adoption of a panel report, which required the consent of all GATT contracting parties under the “consensus rule” to be adopted.⁴⁸ Absent

Council of its intention in respect of implementation of the recommendations or rulings.”

⁴⁶ The 1989 Decision, *supra* note 19, ¶ I.3.

⁴⁷ Jackson, *supra* note 16, at 113.

⁴⁸ Long argues that “it has become more difficult to sustain consensus against the background of the growing diversity of trends and tendencies in trade relations; uncertainties in the world economy; differences in the economic strength, systems and priorities of GATT member governments; and last but not least, the constant pressure of national political constraints.” Long, *supra* note 15, at 88. For a general explanation on this issue, see also William J. Davey, *The WTO Dispute Settlement Mechanism* (Ill. Pub. Law & Legal Theory Research Paper Series, Research Paper No. 03-08, 2003), available at <http://ssrn.com/abstract=419943>; Friedl Weiss, *Improving WTO Procedural Law: Problems and Lessons from the Practice of other International Courts and Tribunals*, in *Improving WTO Dispute Settlement Procedures: Issues & Lessons from the Practice of Other International Courts & Tribunals* 17, 22 (Friedl

adoption, a panel report would simply represent the personal views of the panel, and not an official report. Furthermore, a losing party had the option of blocking the implementation of panel recommendation and the authorization of retaliation, even if a panel report was adopted. In *US – Superfund*, US legislation, the so-called Superfund Act, imposed a tax that differentiated between domestic crude oil and imported petroleum products. The panel concluded that such a measure was in violation of the national treatment requirement of GATT.⁴⁹ While the US did not block the adoption of the report, it refused to comply with the panel ruling by arguing that its trade effects were minimal and the measure concerned did not nullify or impair benefits of the European Communities (EC) and Canada. Authorization for retaliation was requested by the EC and Canada, but it was not approved due to the blockage of authorization by the US.⁵⁰ Thus, in reality, there was no binding requirement for the parties to follow panel reports. It was essentially left up to the discretion of the parties whether they would comply with their GATT obligations.

Second, remedy procedures tended to drag on for years because parties would request time extensions to implement panel recommendations which would make their domestic laws consistent with GATT. In *US – Section 337*, the panel found that Section 337 of the United States Tariff Act of 1930 was inconsistent with Article III:4 of GATT and recommended that the US bring its procedure into conformity with its GATT obligations.⁵¹ However, the US dragged out its compliance until its negotiating

Weiss ed., 2000); Andreas F. Lowenfeld, *Remedies along with Rights: Institutional Reform in the new GATT*, 88 Am. J. Int'l L. 477, 479-480 (1994).

⁴⁹ See generally Report of the Panel, *United States – Taxes on Petroleum and Certain Imported Substances (Superfund)*, L/6175 (June 17, 1987), GATT B.I.S.D. (34th Supp.) at 136 (1988).

⁵⁰ See Communication from Canada, *United States – Taxes on Petroleum and Certain Imported Substances Follow-up on the Panel Report (L/6175)*, L/6559 (Jul. 31, 1989).

⁵¹ See Report of the Panel, *United States – Section 337 of the Tariff Act of 1930*, ¶¶ 6.1-6.4, L/6439 (Nov. 7,

objectives on the treatment of patents were satisfied in the Uruguay Round.⁵² Similarly, in *US – DISC*, the US took twelve years to pass a new statute to replace their prior inconsistent measure.⁵³

Lastly, in the light of the difficulties in dealing with politically sensitive issues, parties would often choose to enforce international trade rules on their own, disregarding the remedy procedures available under GATT. In particular, the US initiated proceedings under Section 301 of the United States Trade Act of 1974 to take unilateral retaliation. The United States Trade Representative (USTR) conducted 91 cases under Section 301 and Special 301, imposing retaliatory measures in 11 of these cases.⁵⁴

These problems were left for the drafters of the WTO agreements to provide changes and improvements.

II. Remedies in the WTO Dispute Settlement System

Unlike GATT, which was purely an agreement, the WTO was established as an integrated organization. It covers a much wider range of trade, including services and intellectual property.

In the Uruguay Round, the governments agreed to replace the GATT dispute

1989), GATT B.I.S.D. (36th Supp.) at 345, 396 (1990).

⁵² See Ernest P. Shriver, *Separate But Equal: Intellectual Property Importation and the Recent Amendments to Section 337*, 5 Minn. J. Global Trade 441 (1996).

⁵³ See generally Report of the Panel, *United States Tax Legislation – “Domestic International Sales Corporation” (DISC)*, L/4422 (Nov. 12, 1976), GATT B.I.S.D. (23rd Supp.) at 98 (1977); Communication from the Commission of the European Communities, *United States Tax Legislation – “Domestic International Sales Corporation” (DISC), Recourse to Article XXIII:2 by the European Communities*, L/3851 (May 1, 1973).

⁵⁴ See Norio Komuro, *The WTO Dispute Settlement Mechanism – Coverage and Procedures of the WTO Understanding*, 29 J. World Trade 5, 74 (1995). For an excellent overview of the WTO case on Section 301, see Seung Hwa Chang, *Taming Unilateralism under the Multilateral Trade System: Unfinished Job in the WTO Panel Ruling on U.S. Sections 301-310 of the Trade Act of 1974*, 31 Law & Pol’y Int’l Bus. 1151 (2000). For more on the issue of unilateral retaliation, see Rachel Brewster, *Shadow Unilateralism: Enforcing International Trade Law at the WTO*, 30 U. Pa. J. Int’l L. 1133 (2009); Jackson, *supra* note 14, at 69-73.

settlement procedure. Thus, there were a number of improvements to the dispute settlement procedure from the inception of the WTO. First, as mentioned earlier, the dispute settlement procedure was incorporated into a single text, the Understanding on Rules and Procedures Governing the Settlement of Disputes, or more commonly referred to as the DSU. The DSU is arguably the most significant achievement of the Uruguay Round negotiations. Many aspects of the WTO dispute settlement procedure were newly introduced, while some parts were inherited from its predecessor, GATT. The members of the WTO have affirmed, under Article 3.1 of the DSU, “their adherence to the principles for the management of disputes heretofore applied under Articles XXII and XXIII of GATT 1947.” The DSU provides the basic rules and procedures of WTO dispute settlement. It applies to disputes between members concerning their rights and obligations under the WTO Agreement.⁵⁵

Second, the establishment of the Appellate Body, a standing body that hears appeals from panel cases, has strengthened the dispute settlement process of the WTO. The review at an appellate stage has led to more “judicial-like” settlement of disputes.

Third, the problems of delay and blockage that existed under GATT were resolved. In the event of non-compliance, a violating WTO member has no right to veto either the adoption of the panel or Appellate Body reports and their legal rulings or the authorization of retaliation. Reports are adopted and retaliation is authorized pursuant to the rule of “reverse-consensus” decision making.⁵⁶ Moreover, the DSU has specified a strict time frame for every procedural stage in order to promote prompt resolution of

⁵⁵ See DSU art. 1.1.

⁵⁶ The “reverse-consensus” rule is that the DSB must grant a request unless all WTO members, including the member that made the request, decide to reject it. It applies to the establishment of a panel, the adoption of panel and Appellate Body reports, and the suspension of concessions or other obligations.

disputes.

In sum, the WTO dispute settlement procedure is automatically applied, without the possibility of blockage by its members, pursuant to strict time limits and through an articulated process, including appellate review. Thus, although it takes over the GATT remedies, in many respects, it is different from the GATT dispute settlement procedure. This has resulted in the strengthened enforceability of WTO obligations. In the following, I will examine the procedural stages of WTO dispute settlement remedies.

1. Withdrawal of Inconsistent Measures

The remedies under the WTO dispute settlement procedure are clearly defined under Article 3.7 of the DSU. At the pre-litigation stage, a solution mutually satisfactory to the parties to a dispute, that is consistent with WTO obligations, is preferred. However, in the absence of such a solution, if litigation ensues, the first objective of the dispute settlement mechanism is to secure the withdrawal of the measures concerned if these are found to be inconsistent with WTO obligations. And if the immediate withdrawal of such measures is impracticable, compensation may be provided. As a last resort, a complaining member may request authorization of retaliation in the form of suspension of concessions or other obligations under WTO obligations. Both compensation and retaliation are temporary measures pending the withdrawal of inconsistent measures.⁵⁷

The dispute settlement process normally results in the adoption of panel or Appellate Body rulings, which take the form of reports.⁵⁸ If a panel or the Appellate Body finds

⁵⁷ DSU art. 3.7.

⁵⁸ The report of a panel and the Appellate Body needs to be adopted by the DSB in order to obtain its legal status. The DSB administers the dispute settlement rules and procedures. It is composed of representatives of all WTO members.

that the measure concerned is inconsistent with WTO obligations, it recommends that the violating member should bring its measure into conformity with the WTO agreement.⁵⁹

A panel or the Appellate Body may also suggest ways in which the member concerned could implement the recommendations.⁶⁰

What is meant by bringing measures into conformity? The concept of compliance is well defined in *Argentina – Hides and Leather*. The arbitrators stated that the concept of compliance is a technical concept requiring specific content, meaning either “*withdrawing* such measure completely,” or “*modifying* it by excising or correcting the offending portion of the measure involved.”⁶¹

Thus, the primary remedy for a breach of WTO obligations is the implementation of a panel or Appellate Body recommendation, which is the withdrawal of inconsistent measures.⁶²

1.1. Prompt Compliance

The DSU calls for “prompt compliance” in order to ensure effective resolution of

⁵⁹ DSU art. 19.1.

⁶⁰ Although there are cases where the panels and Appellate Body have made suggestions, they generally decline to do so, so as to give discretion to members in how they bring their measures into conformity with WTO obligations. *See, e.g.*, Panel Report, *United States – Final Dumping Determination on Softwood Lumber from Canada*, ¶ 8.6, WT/DS264/R (Apr. 13, 2004) (Noting that “a panel is not required to make a suggestion should it not deem it appropriate to do so”); Panel Report, *United States – Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors (DRAMs) of One Megabit or above from Korea*, ¶ 7.4, WT/DS99/R (Jan. 29, 1999) (Noting that there is a “range of possible ways” for the US to “appropriately implement” the panel recommendation).

⁶¹ Award of the Arbitrator, *Argentina – Measures Affecting the Export of Bovine Hides and the Import of Finished Leather, Arbitration under 21.3(c) of the Understanding on Rules and Procedures Governing the Settlement of Disputes*, ¶¶ 40-41, WT/DS155/10 (Aug. 31, 2001) (emphasis original).

⁶² In order to bring an inconsistent measure into conformity, it must have a “continuing character” at the time the panel report is adopted. Panel Report, *United States – Standards for Reformulated and Conventional Gasoline*, ¶ 6.19, WT/DS2/R (Jan. 29, 1996). *See also* Panel Report, *Chile – Price Band System and Safeguard Measures relating to Certain Agricultural Products*, ¶ 7.112, WT/DS207/R (May 3, 2002) (Noting that a panel could recommend a violating member to bring a measure into conformity only when that measure is “still in force”).

disputes to the benefit of all members.⁶³ In order to achieve prompt compliance, a violating member has to begin to implement the recommendations right after the adoption of a panel or Appellate Body report.⁶⁴

1.2. Reasonable Period of Time

However, if it is “impracticable to comply immediately with recommendations and rulings,” the member concerned is given a “reasonable period of time” to comply with its WTO obligations.⁶⁵ In other words, a reasonable period of time is not always available unconditionally. It is provided only when prompt compliance is impracticable.⁶⁶ In practice, however, a claim that a reasonable period of time is required to implement has not been successfully challenged.

The reasonable period of time is normally determined by agreement of the parties to a dispute.⁶⁷ If the parties cannot agree on the period, it is determined through binding arbitration within 90 days after the date of adoption of a report. And the reasonable period of time to implement recommendations should not exceed 15 months from the date of adoption of a report.⁶⁸

⁶³ DSU art. 21.1.

⁶⁴ See Award of the Arbitrator, *United States – Section 110(5) of the US Copyright Act, Arbitration under Article 21.3(c) of the Understanding on Rules and Procedures Governing the Settlement of Disputes*, ¶ 46, WT/DS160/12 (Jan. 15, 2001).

⁶⁵ DSU art. 21.3. For a detailed explanation on the “reasonable period of time,” see Shin-yi Peng, *How Much Time is Reasonable? – The Arbitration Decisions under Article 21.3(c) of the DSU*, 26 Berkeley J. Int’l L. 323 (2008).

⁶⁶ See Award of the Arbitrator, *United States – Continued Dumping and Subsidy Offset Act of 2000, Arbitration under Article 21.3(c) of the Understanding on Rules and Procedures Governing the Settlement of Disputes*, ¶ 40, WT/DS217/14 & WT/DS234/22 (Jun. 13, 2003).

⁶⁷ DSU art. 21.3(b). Parties to a dispute have to mutually agree on a period of time within 45 days after the date of adoption of a report.

⁶⁸ DSU art. 21.3(c).

In an arbitration proceeding, it is beyond the scope of the arbitrators' mandate to suggest ways or means of implementation. Their task is only to determine a reasonable period of time within which implementation must be completed.⁶⁹

During the course of a reasonable period of time, a violating member does not have to provide relief for the past effect of its inconsistent measure. In *US – Section 129(c)(1) URAA*, the panel rejected a request for retroactive relief by recognizing “that a Member’s obligation under the DSU is to provide prospective relief in the form of withdrawing a measure inconsistent with a WTO agreement, or bringing that measure into conformity with the agreement by the end of the reasonable period of time.”⁷⁰

1.3. Compliance Review

When there is disagreement as to the consistency of measures taken to comply with the recommendations, such a dispute can be decided through recourse to “the original panel.”⁷¹ This is often called “compliance review.” The compliance review panel is to “circulate its report within 90 days after the date of referral.”⁷²

Compliance review is not limited to the issue of whether a violating member has implemented the recommendations. It also reviews whether the adopted compliance

⁶⁹ See Award of the Arbitrator, *European Communities – Measures Concerning Meat and Meat Products (Hormones)*, Arbitration under Article 21.3(c) of the Understanding on Rules and Procedures Governing the Settlement of Disputes, ¶ 38, WT/DS26/15 & WT/DS48/13 (May 29, 1998).

⁷⁰ Panel Report, *United States – Section 129(c)(1) of the Uruguay Round Agreements Act*, ¶ 3.93, WT/DS221/R (Jul. 15, 2002). Thus, a violating member may maintain its inconsistent measure until the expiration of the reasonable period of time. However, in *Brazil – Aircraft*, the Appellate Body noted that determining a reasonable period of time under Article 21.3 is not required under the prohibited subsidies provisions of the SCM Agreement. They state that a subsidy must be withdrawn without delay. See Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, ¶ 192, WT/DS46/AB/R (Aug. 2, 1999). For more on this issue, see Ch. 2. Sec. II. 3.3.3.

⁷¹ DSU art. 21.5.

⁷² *Id.*

measure is consistent with WTO obligations.⁷³

Increasingly, WTO members have sought recourse through these compliance review procedures, which may be an undesirable trend. This implies that violating members are making only minor changes to the measures found to be inconsistent with WTO agreements.⁷⁴

2. Compensation

If compliance has not been achieved within a reasonable period of time, the violating member can offer compensation as a temporary measure.⁷⁵ Compensation is intended to ease the adverse effect of an inconsistent measure pending its full elimination. Thus, a complaining member cannot simply request compensation upon the determination of inconsistency of a measure. Only failure to comply with the recommendations and rulings can give rise to the remedy of compensation.

The parties to a dispute may enter into negotiations “no later than the expiry of the reasonable period of time,” “with a view to developing mutually acceptable compensation.”⁷⁶ Compensation normally involves a lifting of trade barriers such as tariff reductions or increases in import quotas by a violating member.

However, compensation is hardly ever offered because of its voluntary nature. Moreover, since it has to conform to the requirements of the Most Favored Nation (MFN)

⁷³ See Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU*, ¶¶ 40-42, WT/DS70/AB/RW (Jul. 21, 2000). See also in *US – Shrimp*, the Appellate Body noted that, when the issue concerns the consistency of a new measure taken to comply, the task of compliance review is to consider that new measure “in its totality.” Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 of the DSU by Malaysia*, ¶ 87, WT/DS58/AB/RW (Oct. 22, 2001) [hereinafter *US – Shrimp*].

⁷⁴ See Davey, *supra* note 48, at 26.

⁷⁵ DSU art. 22.1.

⁷⁶ DSU art. 22.2.

clause, a violating member may effectively have to provide compensation to all its trading partners. Thus, there is reluctance for the violating member to offer compensation. These conditions make compensation less attractive in terms of its implementation.⁷⁷

Up to the present, there have been only four cases where compensation was offered as a mutually acceptable solution. Three of them were provided in the form of trade compensation. In *Japan – Alcoholic Beverages*, Japan provided compensation in the form of tariff reductions with regard to certain products from the complaining members, the US, Canada and the EC.⁷⁸ The compensation was provided because Japan delayed implementation of nondiscriminatory taxation with respect to a certain type of Sochu for five years, which was greatly beyond the reasonable time period of 15 months.⁷⁹ In *Turkey – Textile Imports*, after the reasonable period of time had expired, Turkey agreed to provide compensation to India by removing quantitative restrictions on textile imports and carrying out tariff reductions on certain chemicals from India.⁸⁰ The compensation remained effective until Turkey's compliance with the recommendations and rulings of the DSB.⁸¹ In *US – Line Pipe Safeguard*, Korea and the US agreed to increase the in-quota volume of imports from Korea as a temporary measure pending the quota's termination, if the safeguard measure had not been removed by the expiration of the reasonable period of time.⁸²

⁷⁷ Under MFN treatment, a member has to treat all its trading partners equally in respect of such matters as tariff levels. For more in detail, see Ch. 2. Sec. II. 5.2.2.

⁷⁸ See Mutually Acceptable Solutions on Modalities for Implementation, *Addendum, Japan – Taxes on Alcoholic Beverages*, WT/DS8/17/Add.1, WT/DS10/17/Add.1 & WT/DS11/15/Add.1 (Jan. 12, 1998).

⁷⁹ See Award of the Arbitrator, *Japan – Taxes on Alcoholic Beverages*, *Arbitration under Article 21(3)(c) of the Understanding on Rules and Procedures Governing the Settlement of Disputes*, ¶ 8, WT/DS8/15, WT/DS10/15 & WT/DS11/13 (Feb. 14, 1997).

⁸⁰ See Notification of Mutually Acceptable Solution, *Turkey – Restrictions on Imports of Textile and Clothing Products*, WT/DS34/14 (Jul. 19, 2001).

⁸¹ *Id.*

⁸² See Agreement under Article 21.3(b) of the DSU, *United States – Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea*, WT/DS202/18 (Jul. 31, 2002). See also

Although monetary compensation is neither explicitly provided nor prohibited in the WTO, there was one case in which monetary payment was provided temporarily. In *US – Copyright Act*, Section 110(5) of the US Copyright Act was found to be in violation of the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS).⁸³ Section 110(5) exempted small bars, restaurants, and other public places from paying royalty fees for playing music. The panel found that the US Copyright Act was inconsistent with certain provisions of the TRIPS Agreement and recommended that the US bring its Act into conformity with the WTO agreement.⁸⁴ When the US had not implemented the panel's recommendation, the EC requested the authorization to suspend concessions pursuant to Article 22.2 of the DSU.⁸⁵ However, the US and the EC sought an arbitral award under Article 25 of the DSU to determine the appropriate monetary compensation for a three-year period as a mutually satisfactory temporary arrangement.⁸⁶ Distinctively, the case was first brought to arbitration under Article 25 of the DSU, whereas such determinations are normally conducted by arbitration proceedings arising under Article 22.6.⁸⁷ It determined the level of nullification or impairment of benefits, which amounted to €1,219,900 per year.

Rossella Brevetti, *Bush Signs Proclamation to Implement Line Pipe Agreement with South Korea*, 19 Int'l Trade Rep. (BNA) 1518 (Sept. 5, 2002).

⁸³ Agreement on Trade Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, Legal Instruments – Results of the Uruguay Round, 33 I.L.M. 1125 (1994). [hereinafter TRIPS Agreement].

⁸⁴ See generally Panel Report, *United States – Section 110(5) of the US Copyright Act*, WT/DS160/R (Jun. 15, 2000). For detailed explanations on this case, see Bernard O'Connor & Margareta Djordjevic, *Practical Aspects of Monetary Compensation: The US – Copyright Case*, 8 J. Int'l Econ. L. 127 (2005); Gene M. Grossman & Petros C. Mavroidis, *United States – Section 110(5) of the US Copyright Act, Recourse to Arbitration under Article 25 of the DSU: Would've or Should've? Impaired Benefits due to Copyright Infringement*, 2 World Trade Rev. 233 (2003).

⁸⁵ See Recourse by the European Communities to Article 22.2 of the DSU, *United States – Section 110(5) of the US Copyright Act*, WT/DS160/19 (Jan. 11, 2002).

⁸⁶ See Notification of a Mutually Satisfactory Temporary Arrangement, *United States – Section 110(5) of the US Copyright Act*, WT/DS160/23 (Jun. 26, 2003).

⁸⁷ For the determination of the level of nullification or impairment in the case, see Award of the Arbitrators, *United States – Section 110(5) of the US Copyright Act, Recourse to Arbitration under Article 25 of the DSU*, WT/DS160/ARB25/1 (Nov. 9, 2001).

3. Retaliation

3.1. Authorization of Retaliation

If no satisfactory compensation can be agreed upon within 20 days after the date of expiry of the reasonable period of time, a complaining member may “request authorization from the DSB to suspend concessions or other obligations” under WTO agreements.⁸⁸ Upon receipt of such a request, the DSB shall grant authorization within 30 days of the expiry of the reasonable period of time.⁸⁹ All other possible remedies under the DSU must be exhausted in order to request retaliation.

Like compensation, retaliation is implemented in a temporary manner only when the inconsistent measure has not been removed within a reasonable period of time.⁹⁰ Retaliation is implemented in the form of suspension of concessions or other obligations. Thus, contrary to compensation, retaliation normally implies raising trade barriers by the complaining member. In addition, unlike compensation where a violating member has to compensate all its trading members under MFN treatment, it affects only the members involved in the dispute.

Once the measure found to be inconsistent with the WTO agreement has been removed, retaliation is terminated.

3.2. Cross-Retaliation

In order to suspend concessions or other obligations, a complaining member has to follow the principles and procedures set out in Article 22.3 of the DSU. Accordingly, there are three types of retaliation to be considered in sequence. First, a complaining

⁸⁸ DSU art. 22.2.

⁸⁹ DSU art. 22.6.

⁹⁰ DSU art. 22.1 & 22.8.

member should seek to retaliate with respect to “the same sector(s)” where a panel or the Appellate Body has found a violation or other nullification or impairment.⁹¹ This is often called “parallel retaliation.” In *EC – Bananas (Ecuador) (Article 22.6 – EC)*, the arbitrators have confirmed this principle by noting that it remains the “preferred option” for the complaining member to request retaliation under “one of the same agreements where a violation was found.”⁹²

If a complaining member considers that it is “not practicable or effective” to retaliate in the same sector(s), it may seek to retaliate in other sectors under the same agreement.⁹³ This is often called “cross-sector retaliation.”

If a complaining member considers that it is “not practicable or effective” to retaliate in other sectors under the same agreement, and that the “circumstances are serious enough,” it may seek to retaliate under another agreement.⁹⁴ This is often called “cross-agreement retaliation.”

For the purpose of principles and procedures set out in this Article, “agreement” means the agreements listed in Annex 1A of the WTO Agreement, the Plurilateral Trade Agreements, the GATS, and the TRIPS Agreement.⁹⁵ Thus, the obligations under the Agreement Establishing the World Trade Organization, the DSU, and the Trade Policy Review Mechanism are not subject to retaliation.

The DSU does not provide any guidelines for the interpretation of the phrases:

⁹¹ DSU art. 22.3(a).

⁹² Decision of the Arbitrator, *European Communities – Regime for the Importation, Sales and Distribution of Bananas, Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, ¶ 33, WT/DS27/ARB/ECU (Mar. 24, 2000) [hereinafter *EC – Bananas (Ecuador) (Article 22.6 – EC)*]. See also Decision of the Arbitrator, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Service, Recourse to Arbitration by the United States under Article 22.6 of the DSU*, ¶ 4.21, WT/DS285/ARB (Dec. 21, 2007) [hereinafter *US – Gambling (Article 22.6 – US)*].

⁹³ DSU art. 22.3(b).

⁹⁴ DSU art. 22.3(c).

⁹⁵ DSU art. 22.3(g).

retaliation is “not practicable or effective” and “circumstances are serious enough.” Thus, the decisions of arbitrators are the only sources for their interpretation.

3.2.1. Not Practicable or Effective

In order to cross-retaliate in other sectors under the same agreement or in another agreement, a complaining member has to prove why parallel retaliation is “not practicable or effective.” The arbitrators in *US – Gambling* noted that when a complaining member considers the practicability and effectiveness of retaliation within the same sector of the agreement where a violation has been found, it does not need to find both requirements.⁹⁶ Thus, a complaining member may consider whether it is either “not practicable” or “not effective.”

With respect to the ordinary meaning of “practicable,” the arbitrators in *EC – Bananas (Ecuador) (Article 22.6 – EC)* held that it connotes “available in practice as well as suited for being used in a particular case.”⁹⁷ In subsequent cases such as *US – Gambling (Article 22.6 – US)* and *US – Upland Cotton (Article 22.6 – US)*, the arbitrators also agreed that the term “practicable” relates to “actual availability and feasibility” in practice to the complaining member.⁹⁸

With respect to the meaning of the term “effective,” the arbitrators in *EC – Bananas*

⁹⁶ See *US – Gambling (Article 22.6 – US)*, *supra* note 92, ¶ 4.29. For an excellent overview on this case, see Mark E. Mendel, *Retaliation in the WTO: The Experience of Antigua and Barbuda in US-Gambling*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 310 (Chad P. Bown & Joost Pauwelyn eds., 2010); Mitchell E. Kilby, *The Mouse that Roared: Implications of the WTO Rulings in US – Gambling*, 44 *Tex. Int’l L.J.* 233 (2008); Paul Rothstein, *Moving All-In with World Trade Organization: Ignoring Adverse Rulings and Gambling with the Future of the WTO*, 37 *Ga. J. Int’l & Comp. L.* 151 (2008). See also *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶ 74; Decision of the Arbitrator, *United States – Subsidies on Upland Cotton, Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, ¶¶ 5.69-5.70, WT/DS267/ARB/1 (Aug. 31, 2009) [hereinafter *US – Upland Cotton (Article 22.6 – US)*].

⁹⁷ *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶ 70.

⁹⁸ *US – Gambling (Article 22.6 – US)*, *supra* note 92, ¶ 4.29; *US – Upland Cotton (Article 22.6 – US)*, *supra* note 96, ¶ 5.72.

(*Ecuador*) (*Article 22.6 – EC*) held that it connotes “powerful in effect,” “making a strong impression,” and “having an effect or result.”⁹⁹ Thus, the thrust of this criterion is to ensure the impact of retaliation is “strong” enough to “induce compliance” by the member that failed to bring its measure into conformity with the WTO agreement.¹⁰⁰ In other words, the arbitrators recognized that the objective of inducing compliance could not be achieved if retaliation is neither “available in practice” nor “powerful in effect.”¹⁰¹ However, the “likelihood of compliance” is not sufficient enough to determine the effectiveness of retaliation. Rather, it is “the ability of the complaining party to make effective use of the awarded countermeasures in order to induce such compliance.”¹⁰²

Moreover, when arbitrators considered two situations where there was an economic imbalance between a complaining member and a violating member and the former was highly dependent upon imports from the latter, they noted that retaliation may entail more harmful effects for the member seeking retaliation than for the other. In these circumstances, they determined that retaliation expected to be “least harmful” to the complaining member would seem to be sufficient.¹⁰³ However, the arbitrators in *US – Upland Cotton* (*Article 22.6 – US*) disagreed with the arbitrators’ determination in *EC – Bananas (Ecuador)* (*Article 22.6 – EC*).¹⁰⁴ They argued that the term “effective” involves an assessment of the effectiveness of retaliation “*in the same sector or under the same agreement*,” rather than an assessment of the “relative effectiveness” of such

⁹⁹ *EC – Bananas (Ecuador)* (*Article 22.6 – EC*), *supra* note 92, ¶ 72.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* ¶ 76. *See also US – Gambling* (*Article 22.6 – US*), *supra* note 92, ¶ 4.84 (Noting that “the thrust of the ‘effectiveness’ criterion empowers the party seeking suspension to ensure that the impact of that suspension is strong and has the desired result, namely to induce compliance by the Member which fails to bring WTO-inconsistent measures into compliance with DSB rulings within a reasonable period of time”).

¹⁰² *US – Upland Cotton* (*Article 22.6 – US*), *supra* note 96, ¶ 5.81.

¹⁰³ *EC – Bananas (Ecuador)* (*Article 22.6 – EC*), *supra* note 92, ¶ 73.

¹⁰⁴ *US – Upland Cotton* (*Article 22.6 – US*), *supra* note 96, ¶ 5.78.

retaliation “in another sector or agreement.”¹⁰⁵ Accordingly, a complaining member was not entitled “to freely choose *the most* effective sector or agreement under which to seek suspension.” Rather, it was found that a complaining member was entitled to “move out of the same sector or same agreement,” if retaliation “*in that sector or agreement* is not ‘practicable or effective.’”¹⁰⁶ However, they did agree with the arbitrators in *EC – Bananas (Ecuador)* (Article 22.6 – EC) that the question of whether certain retaliation entails more harmful effects for the party seeking retaliation than for the other would be pertinent to a consideration of the term “effectiveness.”¹⁰⁷

In my view, the arbitrators in *US – Upland Cotton* (Article 22.6 – US) appear to be correct in the sense that Article 22.3(b) of the DSU clearly requires a complaining member to assess whether same-sector or same-agreement retaliation is “not practicable or effective.” Furthermore, under Article 22.3(d)(i), they have to consider “the trade in the sector or under the agreement under which the panel or Appellate Body has found a violation or other nullification or impairment.”

In *US – Gambling* (Article 22.6 – US), because of the low volume of imports on the sector where the violation was found and the likely trade impact on US service providers and Antiguan consumers, the arbitrators concluded that it was not practicable or effective for Antigua to retaliate in the same sector.¹⁰⁸ In particular, they noted that Antigua, as a relatively small import-dependent economy, may suffer an adverse impact from retaliating not only in the same sector but also in the other sectors under the same-agreement, the General Agreement on Trade in Services (GATS), and there would be

¹⁰⁵ *Id.* (emphasis original).

¹⁰⁶ *Id.* (emphasis original).

¹⁰⁷ *Id.* ¶ 5.79.

¹⁰⁸ *US – Gambling* (Article 22.6 – US), *supra* note 92, ¶ 4.60.

“virtually no impact” on the US while making services more expensive for Antiguan consumers.¹⁰⁹

3.2.2. Circumstances are Serious Enough

In order to seek cross-agreement retaliation, a complaining member is required to determine that “the circumstances are serious enough,” in addition to determining that retaliation under the same agreement would be “not practicable or effective.” These are “cumulative conditions” that have to be met in order to retaliate under another agreement.¹¹⁰

With respect to the meaning of “circumstances,” the arbitrators in *US – Gambling* (*Article 22.6 – US*) noted that “the circumstances that are relevant may vary from case to case.” Thus, an assessment of “circumstances” is made on a “case-by-case basis.”¹¹¹ However, circumstances are considered “serious enough” only when “the circumstances reach a certain degree or level of importance.”¹¹² In this regard, the arbitrators in *US – Upland Cotton* (*Article 22.6 – US*) agreed with the arbitrators’ determination in *US – Gambling* (*Article 22.6 – US*), which found that circumstances imply a “degree of flexibility in assessing what ‘circumstances’ may be pertinent in a given case, so that these may not be the only relevant considerations in such an assessment.”¹¹³ Thus, the evaluation of whether circumstances are serious enough to warrant cross-agreement retaliation will differ depending on the circumstances of a particular case.

In *US – Gambling* (*Article 22.6 – US*), the arbitrators noted the considerable disparity

¹⁰⁹ *Id.* ¶¶ 4.89, 4.92-4.94 & 4.97-4.99.

¹¹⁰ *Id.* ¶ 4.69.

¹¹¹ *Id.* ¶ 4.108.

¹¹² *Id.*

¹¹³ *US – Upland Cotton* (*Article 22.6 – US*), *supra* note 96, ¶ 5.84.

between Antigua and the US in terms of size, economy and natural resources, and the fact that Antigua is highly dependent on tourism and associated services. The arbitrators found that these conditions “exacerbate the difficulties in finding a way to suspend concessions or other obligations in a practicable or effective manner” under the same agreement.¹¹⁴ As such, they concluded that the circumstances were serious enough to justify retaliation under another agreement. It appears that circumstances are deemed to be serious enough when “extremely unbalanced nature of the trading relations” between two disputing members exists and when a complaining member heavily relies on “the very sector that would be candidates for retaliation.”¹¹⁵

Moreover, the arbitrators in *US – Upland Cotton (Article 22.6 – US)* held that the subsidies at issue in that case had created “an artificial and persisting competitive advantage for US producers over all other operators,” and, therefore, this had a “trade-distorting impact” not only on the US market but also on the world market in cotton industries.¹¹⁶ In this regard, they concluded that the circumstances were serious enough to justify retaliation under another agreement because retaliation only in the same sector or the same agreement would have a disproportionate adverse impact on Brazil’s economy.¹¹⁷ Thus, it appears that the arbitrators also consider the trade-distorting impact of an inconsistent measure in its determination of whether the circumstances are serious enough.

¹¹⁴ *US – Gambling (Article 22.6 – US)*, *supra* note 92, ¶¶ 4.110-4.111 & 4.113.

¹¹⁵ *Id.* ¶ 4.114. The arbitrators in *EC – Bananas (Ecuador) (Article 22.6 – EC)* also considered the statistics displaying the economic inequality between Ecuador and the EC and determined that circumstances were serious enough to justify cross-agreement retaliation. *See EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶¶ 125-126.

¹¹⁶ It also noted that “these trade-distorting effects are not insignificant” and will be “further amplified.” *US – Upland Cotton (Article 22.6 – US)*, *supra* note 96, ¶¶ 5.219-5.220.

¹¹⁷ *See id.* ¶ 5.221.

3.2.3. In Relation to Article 22.3(d) of the DSU

In order to seek cross-sector and cross-agreement retaliation, a complaining party has to take into account two elements. First, it must consider the “trade in the sector or under the agreement” under which a violation has been found and the “importance of such trade” to the complaining member.¹¹⁸ Second, it must consider the “broader economic elements” relating to the nullification or impairment and the “broader economic consequences” of retaliation.¹¹⁹

As to the first element, the arbitrators in *EC – Bananas (Ecuador) (Article 22.6 – EC)* held that the term “trade in the sector” is only the “trade nullified or impaired by the WTO-inconsistent measure at issue.”¹²⁰ However, both arbitrators in *US – Gambling (Article 22.6 – US)* and *US – Upland Cotton (Article 22.6 – US)* disagreed with such a view. Instead, they considered the entirety of the “trade in the sector or under the agreement” where a violation had been found.¹²¹ Thus, if there is a violation found in a particular good, the importance of all trade in goods has to be in consideration.

As to the second element, the “broader economic elements” relating to the member suffered from nullification or impairment and the “broader economic consequences” of retaliation must be considered, both from the perspective of the complaining member and the violating member.¹²² The reason for the latter criterion is that retaliation may have an adverse effect to the complaining member seeking it, “especially where a great imbalance in terms of trade volumes and economic power exists” between the two disputing

¹¹⁸ DSU art. 22.3(d)(i).

¹¹⁹ DSU art. 22.3(d)(ii).

¹²⁰ *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶ 83.

¹²¹ *US – Gambling (Article 22.6 – US)*, *supra* note 92, ¶ 4.33; *US – Upland Cotton (Article 22.6 – US)*, *supra* note 96, ¶¶ 5.85-5.87.

¹²² *US – Gambling (Article 22.6 – US)*, *supra* note 92, ¶¶ 4.61-4.63; *US – Upland Cotton (Article 22.6 – US)*, *supra* note 96, ¶¶ 5.88-5.89.

members.¹²³

3.3. Determination of the Level of Retaliation

3.3.1. General Remarks

If all of the above requirements have been met, the DSB shall grant authorization for retaliation. However, if one of the parties to the dispute disagrees with the level of proposed retaliation, or claims that the principles or procedures set out in Article 22.3 have not been followed, “the matter shall be referred to arbitration.”¹²⁴ “Such arbitration shall be carried out by the original panel” and “shall be completed within 60 days after the date of expiry of the reasonable period of time.”¹²⁵ Retaliation would not be implemented “during the course of the arbitration.”¹²⁶

With regard to the mandate of the arbitrator, it may determine (1) whether the level of retaliation is equivalent to the level of nullification or impairment, (2) whether retaliation is allowed under the covered agreement, and (3) whether the procedures and principles of Article 22.3 have been followed.¹²⁷ The arbitrator may not examine “the nature of retaliation to be implemented.”¹²⁸ The arbitrators in *US – Offset Act (Byrd Amendment) (Brazil) (Article 22.6 – US)* stated that it did not fall within their mandate “to recommend the suspension of specific obligations or the adoption of specific measures” by the complaining party.¹²⁹ In addition, in *US – 1916 Act (EC) (Article 22.6 – US)*, when the

¹²³ See *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶ 86.

¹²⁴ DSU art. 22.6.

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ See DSU art. 22.7.

¹²⁸ *Id.*

¹²⁹ Decision of the Arbitrator, *United States – Continued Dumping and Subsidy Offset Act of 2000, Recourse to Arbitration by the United States under Article 22.6 of the DSU*, ¶ 4.11, WT/DS217/ARB/BRA (Aug. 31, 2004) [hereinafter *US – Offset Act (Byrd Amendment) (Brazil) (Article 22.6 – US)*]. See also

EC requested to suspend obligations in lieu of tariff concessions, the arbitrators ruled that this was not within the scope of their authority.¹³⁰

The members concerned shall accept the “arbitrator’s decision as final” and “shall not seek a second arbitration.”¹³¹

3.3.2. Standard of Equivalence

As mentioned above, arbitrators have to determine whether the level of retaliation is “equivalent” to the “level of nullification or impairment.”¹³² The term “equivalence” implies a balance between two levels and requires a stricter balance than what was required under the appropriateness standard of GATT. The level of nullification or impairment compares the trade value of the WTO-inconsistent measures in dispute with what they should have been had the measures been in compliance with WTO obligations. Then, it requires the level of retaliation to be identical to the calculated level of that trade value. Thus, the equivalence standard restricts the value of trade eliminated by suspension to the value of trade nullified by the violation. With respect to the meaning of equivalence, the arbitrators in *EC – Bananas (US) (Article 22.6 – EC)* noted that it is “equal in value, significance or meaning,” “having the same effect,” “having the same relative position or function,” “corresponding to,” “something equal in value or worth,”

Decision of the Arbitrator, *European Communities – Measures Concerning Meat and Meat Products (Hormones)*, *Recourse to the Arbitration by the European Communities under Article 22.6 of the DSU*, ¶ 19, WT/DS26/ARB (Jul. 12, 1999) [hereinafter *EC – Hormones (US) (Article 22.6 – EC)*].

¹³⁰ Decision of the Arbitrator, *United States – Anti-Dumping Act of 1916 Act, Recourse to Arbitration by the United States under Article 22.6 of the DSU*, ¶ 3.7, WT/DS136/ARB (Feb. 24, 2004) [hereinafter *US – 1916 Act (EC) (Article 22.6 – US)*].

¹³¹ DSU art. 22.7.

¹³² *Id.* For an excellent explanation on the standard of equivalence, see Thomas Sebastian, *The Law of Permissible WTO Retaliation*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 89, 99-114 (Chad P. Bown & Joost Pauwelyn eds., 2010). Unlike GATT where an “appropriate” retaliatory measure was to be judged by reference to the level of nullification and impairment, the WTO requires a stricter use of retaliation by using the term “equivalent.”

and also “something tantamount or virtually identical.”¹³³ Thus, they considered that the term equivalence “connotes a correspondence, identity or balance between two related levels, i.e., between the level of the concessions to be suspended, on the one hand, and the level of the nullification or impairment, on the other.”¹³⁴

3.3.2.1. Level of Nullification or Impairment

In determining both the level of retaliation and the level of nullification or impairment, the same basis would be needed.¹³⁵ However, neither the WTO agreement nor case law provides a clear definition of either criterion. Only a few precedents provide guidelines for determining the level of nullification or impairment.

First, the presumption of nullification or impairment set out in Article 3.8 of the DSU cannot be taken as evidence for proving the level of nullification or impairment under Article 22 of the DSU.¹³⁶ This implies that a mere presumption of nullification or impairment would not be sufficient enough to determine the level of retaliation. Second, the “trade effect” approach can be a parameter for determining the level of nullification or impairment.¹³⁷ Third, the loss of indirect benefits by a complaining member does not constitute nullification or impairment. The arbitrators in *EC – Bananas (US) (Article 22.6 – EC)* concluded that the loss of the US exports to Latin America, which were the fertilizers that would have been used in the cultivation of bananas that would have been exported to the EC absent the violation, could not be considered for calculating

¹³³ Decision of the Arbitrator, *European Communities – Regime for the Importation, Sale and Distribution of Bananas, Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, ¶ 4.1, WT/DS27/ARB (Apr. 9, 1999) [hereinafter *EC – Bananas (US) (Article 22.6 – EC)*].

¹³⁴ *Id.*

¹³⁵ *See, e.g., id.* ¶ 7.1.

¹³⁶ *See id.* ¶ 6.10.

¹³⁷ *See US – Offset Act (Byrd Amendment) (Brazil) (Article 22.6 – US)*, *supra* note 129, ¶¶ 3.70-3.71.

nullification or impairment.¹³⁸ Fourth, a measure found to be inconsistent with the WTO agreement has to be quantifiable in order to be included in the calculation of nullification or impairment. In *US – 1916 Act (EC) (Article 22.6 – US)*, the EC had argued that “the most damaging effect of the 1916 Act is its ‘chilling effect’ on the commercial behaviour of European companies and its potential use as a means of intimidation of European companies that are either already active on the US market or which consider entering the market.”¹³⁹ However, the arbitrators concluded that, because the “chilling effect” could not be meaningfully quantified, it could not be included in the calculation of the level of nullification or impairment.¹⁴⁰

3.3.2.2. Level of Retaliation

With regard to the determination of the level of retaliation, it involves both quantitative and qualitative assessments of the proposed retaliation. The arbitrators in *EC – Hormones (US) (Article 22.6 – EC)* found that the determination of the level of retaliation being “equivalent” to the level of nullification or impairment had to be determined in “quantitative” terms.¹⁴¹ Similarly, the arbitrators in *US – FSC (Article 22.6 – US)* stated that “[t]he drafters have explicitly set a quantitative benchmark” to the level of retaliation.¹⁴²

¹³⁸ *EC – Bananas (US) (Article 22.6 – EC)*, *supra* note 133, ¶¶ 6.8 & 6.10-6.12.

¹³⁹ *US – 1916 Act (EC) (Article 22.6 – US)*, *supra* note 130, ¶ 5.64.

¹⁴⁰ *See id.* ¶¶ 5.69-5.72. *See also* Decision of the Arbitrator, *Canada – Export Credits and Loan Guarantees for Regional Aircraft, Recourse to Arbitration by Canada under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, ¶ 3.22, WT/DS222/ARB (Feb. 17, 2003) (Noting that, although a “revealed margin of preference” for a Canadian regional aircraft manufacturer may have existed, it has not meaningfully “quantified” such preference) [hereinafter *Canada – Aircraft Credits and Guarantees (Article 22.6 – Canada)*].

¹⁴¹ *EC – Hormones (US) (Article 22.6 – EC)*, *supra* note 129, ¶ 20. For an economic analysis of the level of retaliation of this case, see Jason Bernstein & David Skully, *Calculating Trade Damages in the Context of the World Trade Organization’s Dispute Settlement Process*, 25 Rev. Agric. Econ. 385 (2003).

¹⁴² Decision of the Arbitrator, *United States – Tax Treatment for “Foreign Sales Corporations,” Recourse*

However, in *US – 1916 Act (EC) (Article 22.6 – US)*, the EC, for the first time, requested “qualitatively” equivalent retaliation.¹⁴³ The arbitrators compared the “quantitative equivalence” from all previous cases to the “qualitative equivalence” in the present case and concluded that the mere fact that the requested retaliation had not been stated in quantitative terms “does not in and of itself render the EC request inconsistent with Article 22.”¹⁴⁴ However, it further noted that it would be impossible to determine the WTO-consistency of a “qualitative equivalence” in the abstract, and thus, found that it would be necessary to “determine how the actual suspension resulting from such ‘qualitative equivalence’ would be *applied*.”¹⁴⁵ In order to make such a determination, the arbitrators noted that it would be necessary to determine “the trade or economic effects” on the EC of the 1916 Act “in numerical or monetary terms.”¹⁴⁶ Given this finding, in assessing “qualitative equivalence,” the level of requested retaliation also has to be quantified and must not exceed the quantified level of nullification or impairment.¹⁴⁷

3.3.3. Exception: Retaliation under the SCM Agreement

3.3.3.1. Special and Additional rules

There is an exception to the rules and procedures of retaliation set forth in Article 22 of the DSU. The Agreement on Subsidies and Countervailing Measures (SCM) provides

to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement, ¶ 5.46, WT/DS108/ARB (Aug. 30, 2002) [hereinafter *US – FSC (Article 22.6 – US)*].

¹⁴³ *US – 1916 Act (EC) (Article 22.6 – US)*, *supra* note 130, ¶ 5.17.

¹⁴⁴ *Id.* ¶¶ 5.18-5.21.

¹⁴⁵ *Id.* ¶ 5.21 (emphasis original).

¹⁴⁶ *Id.* ¶ 5.23.

¹⁴⁷ *Id.* ¶¶ 8.1-8.2.

independent rules and procedures of dispute settlement including remedies.¹⁴⁸ It uses a different term for retaliation, that is, “countermeasures.”

The SCM Agreement rules are special and additional to the rules of the DSU. In *Brazil – Aircraft (Article 22.6 – Brazil)*, the arbitrators indicated that the provisions of Article 4.11 of the SCM Agreement must be read as “special or additional rules.”¹⁴⁹ Nonetheless, the arbitral procedure under Article 22.6 of the DSU remains applicable to the arbitration pursuant to the SCM Agreement, although the latter prevails in case of conflict.¹⁵⁰

There are two types of countermeasures under the SCM Agreement: countermeasures against prohibited subsidies and countermeasures against actionable subsidies. I will explain them respectively in the following.

3.3.3.2. Countermeasures against Prohibited Subsidies

Prohibited subsidies include export subsidies, which are “subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance” and import substitution subsidies, which are “subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.”¹⁵¹

¹⁴⁸ Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Legal Instruments – Results of the Uruguay Round, 33 I.L.M. 1125 (1994) [hereinafter SCM Agreement].

¹⁴⁹ Decision of the Arbitrator, *Brazil – Export Financing Programme for Aircraft, Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, ¶ 3.57, WT/DS46/ARB (Aug. 28, 2000) [hereinafter *Brazil – Aircraft (Article 22.6 – Brazil)*].

¹⁵⁰ See *US – FSC (Article 22.6 – US)*, *supra* note 142, ¶ 2.6; Decision of the Arbitrator, *United States – Subsidies on Upland Cotton, Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement*, ¶¶ 4.18-4.19, WT/DS267/ARB/2 (Aug. 31, 2009) [hereinafter *US – Upland Cotton (Article 22.6 – US II)*].

¹⁵¹ SCM Agreement art. 3.1. For a general explanation on subsidies and countervailing measures, see Marc Benitah, *The Law of Subsidies under the GATT/WTO System* (2001).

Article 4 of the SCM Agreement provides the rules and procedures of remedies with respect to prohibited subsidies. In contrast to the DSU, it provides a concrete method and period for implementation, which directs the violating member to “withdraw the subsidy without delay.”¹⁵² There are no provisions on compensation in case of non-compliance. Instead, only countermeasures are provided for. If the subsidizing member fails to withdraw the subsidy within the specified time period, the DSB shall authorize the complaining member to take “appropriate countermeasures, unless the DSB decides by consensus to reject the request.”¹⁵³ In order to request countermeasures pursuant to Article 4.10 of the SCM Agreement, such countermeasures have to meet the appropriateness standard.

3.3.3.2.1. Countermeasures

The term “countermeasures” is another name for retaliation and is used only in the SCM Agreement.¹⁵⁴ In *US – FSC (Article 22.6 – US)*, the arbitrators looked at dictionary definitions of the term “countermeasures”:

Dictionary definitions of “countermeasure” suggest that a countermeasure is essentially defined by reference to the wrongful action to which it is intended to respond. The New Oxford Dictionary defines “countermeasure” as “an action taken to counteract a danger, threat, etc.” The meaning of “counteract” is to “hinder or defeat by contrary action; neutralize the action or effect of.” Likewise, the term “counter” used as a prefix is defined *inter alia* as: “opposing, retaliatory.” The ordinary meaning of the term thus suggests that a countermeasure bears a relationship with the action to be counteracted, or with its effects (cf. “hinder or defeat by contrary action; neutralize the action or effect of”).

¹⁵² SCM Agreement art. 4.7.

¹⁵³ SCM Agreement art. 4.10.

¹⁵⁴ The term “countermeasures” under Article 4 of the SCM Agreement includes the suspension of concessions or other obligations. See *Brazil – Aircraft (Article 22.6 – Brazil)*, *supra* note 149, ¶¶ 3.28-3.29.

In the context of Article 4 of the SCM Agreement, the term “countermeasures” is used to define temporary measures which a prevailing Member may be authorized to take in response to a persisting violation of Article 3 of the SCM Agreement, pending full compliance with the DSB’s recommendations. This use of the term is in line with its ordinary dictionary meaning as described above: these measures are authorized to counteract, in this context, a wrongful action in the form of an export subsidy that is prohibited *per se*, or the effects thereof.¹⁵⁵

In this regard, countermeasures are temporary measures that are taken in response to a failure to withdraw a subsidy within a specified time period. However, the term “countermeasures,” in and of itself, does not necessarily indicate “an intention to refer to retaliatory action that ‘goes beyond the mere rebalancing of trade interests.’”¹⁵⁶

The arbitrators in *Brazil – Aircraft (Article 22.6 – Brazil)*, however, disregarded the dictionary definitions of the term “countermeasures,” and referred to its meaning in public international law and the ILC Draft. Particularly, they considered the term “countermeasures” in Article 47 of the ILC Draft and noted that they are meant to “induce [the State which has committed an internationally wrongful act] to comply with its obligations.”¹⁵⁷ Thus, the term “countermeasures” under the SCM Agreement also corresponds to the term used in public international law.

3.3.3.2.2. Appropriate Countermeasures

¹⁵⁵ *US – FSC (Article 22.6 – US)*, *supra* note 142, ¶¶ 5.4-5.5.

¹⁵⁶ *US – Upland Cotton (Article 22.6 – US)*, *supra* note 96, ¶ 4.38.

¹⁵⁷ *Brazil – Aircraft (Article 22.6 – Brazil)*, *supra* note 149, ¶ 3.44. *See also US – Upland Cotton (Article 22.6 – US)*, *supra* note 96, ¶¶ 4.39-4.41.

There are at least three factors to be considered when determining the appropriateness of countermeasures: bounded flexibility, proportionality, and the compliance-inducing effect. These are cumulative conditions that must be considered as a whole.¹⁵⁸

3.3.3.2.2.1. Bounded Flexibility

The arbitrators in *US – FSC (Article 22.6 – US)* noted that, as far as the level of countermeasures is concerned, the expression “appropriate” does not in and of itself define “the precise and exhaustive conditions for the application of countermeasures.”¹⁵⁹ Thus, according to the plain meaning, “countermeasures should be adapted to the particular case at hand,” providing a degree of flexibility, “in the sense that there is thereby an eschewal of any rigid *a priori quantitative* formula.”¹⁶⁰ Similarly, the arbitrators in *US – Upland Cotton (Article 22.6 – US)* agreed that, in assessing the “appropriateness” of proposed countermeasures, it connotes “the notion of something being ‘adapted’ or ‘suited’ to the particular situation at hand” and the relationship between countermeasures and “all of the circumstances of a particular case.”¹⁶¹ This implies that “it is appropriate to take into account not only the existence of the violation in itself, but also the specific circumstances that arise from the breach for the complaining party seeking to apply countermeasures.”¹⁶²

However, the degree of flexibility in what might be considered “appropriate” in a particular case does not mean that it is unbounded. The expression “disproportionate” in

¹⁵⁸ In *Canada – Aircraft Credits and Guarantees (Article 22.6 – Canada)*, the compliance-inducing effect alone was insufficient to determine the level of countermeasures as appropriate. See *Canada – Aircraft Credits and Guarantees (Article 22.6 – Canada)*, *supra* note 140, ¶ 3.48.

¹⁵⁹ *US – FSC (Article 22.6 – US)*, *supra* note 142, ¶ 5.10.

¹⁶⁰ *Id.* ¶ 5.11.

¹⁶¹ *US – Upland Cotton (Article 22.6 – US)*, *supra* note 96, ¶¶ 4.46-4.47.

¹⁶² *Id.* ¶ 4.54.

footnote 9 to Article 4.10 of the SCM Agreement confirms that, “while the notion of ‘appropriate countermeasures’ is intended to ensure sufficient flexibility of response to a particular case, it is a flexibility that is distinctly bounded.”¹⁶³

3.3.3.2.2.2. Proportionality

Footnote 9 to Article 4.10 of the SCM Agreement clarifies the term “appropriate” countermeasures. It provides that the term “appropriate” does not allow “countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited.”¹⁶⁴ The arbitrators in *US – Upland Cotton (Article 22.6 – US)* understood this requirement to be a “protection against excessive countermeasures.”¹⁶⁵

In *US – FSC (Article 22.6 – US)*, the arbitrators held that the term appropriateness “entails an avoidance of disproportion between the proposed countermeasures and . . . either the actual violating measure itself, the effects thereof on the affected Member, or both.”¹⁶⁶ They further noted that “the negative formulation of the requirement under footnote 9 is consistent with a greater degree of latitude than a positive requirement may have entailed,” which may not require “strict proportionality.”¹⁶⁷

3.3.3.2.2.3. Compliance-Inducing Effect

¹⁶³ *US – FSC (Article 22.6 – US)*, *supra* note 142, ¶ 5.19. *See also US – Upland Cotton (Article 22.6 – US)*, *supra* note 96, ¶ 4.85.

¹⁶⁴ SCM Agreement art. 4.10 n.9.

¹⁶⁵ *US – Upland Cotton (Article 22.6 – US)*, *supra* note 96, ¶ 4.85. *See also Canada – Aircraft Credits and Guarantees (Article 22.6 – Canada)*, *supra* note 140, ¶ 3.49.

¹⁶⁶ *US – FSC (Article 22.6 – US)*, *supra* note 142, ¶ 5.19.

¹⁶⁷ *Id.* ¶ 5.26.

The arbitrators in *Brazil – Aircraft* (Article 22.6 – *Brazil*) considered the term “countermeasures” based on Article 47 of the ILC Draft and concluded that “a countermeasure is ‘appropriate’ *inter alia* if it *effectively* induces compliance.”¹⁶⁸ In this regard, the arbitrators in *Canada – Aircraft Credits and Guarantees* (Article 22.6 – *Canada*) adjusted the level of countermeasures by adding 20 per cent to the amount of the subsidy.¹⁶⁹ They considered it appropriate because, at the time of the decision, Canada had indicated that it had no intention to withdraw the subsidy at issue and, thus, there was a need for “a level of countermeasures which can reasonably contribute to induce compliance.”¹⁷⁰

Distinctively, the arbitrators in *US – Upland Cotton* (Article 22.6 – *US*) also agreed that countermeasures under Article 4.10 of the SCM Agreement “serve to ‘induce compliance,’” but noted that “this purpose does not, in and of itself, distinguish Article 4.10 from the other comparable provisions in the WTO Agreement.”¹⁷¹ Rather, as they further noted, inducing compliance is the common purpose of all retaliatory measures in the WTO dispute settlement system, and thus, this factor may not “in and of itself provide specific indications as to the *level* of countermeasures that may be permissible under this provision.”¹⁷²

3.3.3.2.3. Subsidy Amount vs. Trade Effect

Before the arbitrators in *US – Upland Cotton* (Article 22.6 – *US*) determined the level of countermeasures, three preceding cases had determined the level of countermeasures

¹⁶⁸ *Brazil – Aircraft* (Article 22.6 – *Brazil*), *supra* note 149, ¶ 3.44 (emphasis original). See also *US – FSC* (Article 22.6 – *US*), *supra* note 142, ¶ 5.57.

¹⁶⁹ *Canada – Aircraft Credits and Guarantees* (Article 22.6 – *Canada*), *supra* note 140, ¶ 3.121.

¹⁷⁰ *Id.* ¶ 3.119.

¹⁷¹ *US – Upland Cotton* (Article 22.6 – *US*), *supra* note 96, ¶¶ 4.111-4.112.

¹⁷² *Id.* ¶ 4.112 (emphasis original).

based on the amount of subsidy.

In *Brazil – Aircraft (Article 22.6 – Brazil)*, the arbitrators noted that appropriate countermeasures do not call for exact equivalence to the level of nullification or impairment, that is, adverse trade effects, and that the “concept of nullification or impairment is absent from Articles 3 and 4 of the SCM Agreement.”¹⁷³ They found that there is no language in the context of Article 4.10 that the level of countermeasures could be read as amounting to the trade effect.¹⁷⁴ They further noted that requiring countermeasures to be equivalent to the level of nullification or impairment would be “contrary to the principle of effectiveness by significantly limiting the efficacy of countermeasures in the case of prohibited subsidies.”¹⁷⁵ To this end, they concluded that the total amount of subsidy would be appropriate when dealing with prohibited subsidies.¹⁷⁶ The arbitrators in *US – FSC (Article 22.6 – US)* also observed that there was no presumption that “the drafters intended the standard under Article 4.10 to be necessarily coextensive with that under Article 22.4 [of the DSU] so that the notion of ‘appropriate countermeasures’ under Article 4.10 would limit such countermeasures to an amount ‘equivalent to the level of nullification or impairment’ suffered by the complaining Member.”¹⁷⁷ Although they conceded that the trade effect of the subsidy was a relevant factor for determining appropriate countermeasures, the trade effect approach was excluded because it was not required as a criterion for this case.¹⁷⁸ The arbitrators in *Canada – Aircraft Credits and Guarantees (Article 22.6 – Canada)* also came to a similar conclusion. Although they noted that the trade effects approach could

¹⁷³ *Brazil – Aircraft (Article 22.6 – Brazil)*, *supra* note 149, ¶¶ 3.47-3.48 & 3.57.

¹⁷⁴ *Id.* ¶ 3.49.

¹⁷⁵ *Id.* ¶ 3.58.

¹⁷⁶ *Id.* ¶ 3.60.

¹⁷⁷ *US – FSC (Article 22.6 – US)*, *supra* note 142, ¶ 5.47.

¹⁷⁸ *See id.* ¶¶ 6.33-6.34.

be applicable to Article 4.10 countermeasures, they refused to follow this approach, concluding that the responding member, Canada, had raised sufficient doubts as to the validity of Brazil's attempts to calculate the trade effects. Canada conceded, however, that using the amount of subsidy would be appropriate.¹⁷⁹ Thus, in the three prior cases, the arbitrators used the amount of the subsidy as the basis for the determination of appropriate countermeasures.

However, in *US – Upland Cotton (Article 22.6 – US)*, the arbitrators considered that “[t]he trade-distorting impact of the prohibited subsidy at issue on the complaining Member effectively reflects the manner in which the economic position of the complaining party to the dispute has been disrupted and harmed by the illegal measure.”¹⁸⁰ For its analysis, they focused on the term “disproportionate” in footnote 9 to Article 4.10 of the SCM Agreement:

We considered that countermeasures would be “disproportionate” if they were excessive, having regard to the extent to which the trade between the parties in dispute has been affected. In other words, countermeasures that do not have a proper relationship to the extent to which the interests of the complaining Member have been adversely affected by the measure would be “disproportionate.”¹⁸¹

Thus, the requirements that countermeasures be “appropriate” and not be “disproportionate” suggest that “there should be a degree of relationship between the level of countermeasures and the trade-distorting impact of the measure on the

¹⁷⁹ See *Canada – Aircraft Credits and Guarantees (Article 22.6 – Canada)*, *supra* note 140, ¶¶ 3.20-3.23 & 3.27-3.29.

¹⁸⁰ *US – Upland Cotton (Article 22.6 – US)*, *supra* note 96, ¶ 4.58.

¹⁸¹ *Id.* ¶ 4.92. The arbitrators also determined that “footnote 9 further invites us to ensure that the countermeasures to be authorized are not excessive, having regard to the extent to which the trade of the complaining party has been affected, and taking into account also the prohibited nature of the subsidy.” *Id.* ¶ 4.114.

complaining Member.” Although the arbitrators noted that the amount of the subsidy could be an appropriate standard, they also found that such a standard did not fully capture the trade-distorting impact of the subsidy.¹⁸² In this regard, they concluded that the level of countermeasures should be based on the calculation of the trade-distorting impact that arises from the failure to withdraw the subsidy within the specified time period.

3.3.3.3. Countermeasures against Actionable Subsidies

Actionable subsidies adversely affect the interests of other members in the forms of “injury to the domestic industry of another Member,” “nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994,” and “serious prejudice to the interests of another Member.”¹⁸³ Article 7 of the SCM Agreement provides the rules and procedures of remedies with respect to actionable subsidies. In contrast to the remedies under prohibited subsidies, where the subsidizing member has no choice but to withdraw the subsidy without delay, where actionable subsidies are found, the subsidizing member may choose either to remove the adverse effects or to withdraw the subsidy.¹⁸⁴ The disputing members may also agree on compensation. If the subsidizing member fails to remove the adverse effects of the subsidy or withdraw the subsidy within six months after the adoption of the report, and in the absence of agreement on compensation, the DSB shall authorize the complaining member to take countermeasures

¹⁸² See *id.* ¶¶ 4.135-4.136. The arbitrators noted that, on the basis of the subsidy amount approach, both members incorporated the “elements that aim to capture the trade effects of the measure.” They then used those elements as the basis for calculation in determining the trade effects. See *id.* ¶¶ 4.170 & 4.184-4.198.

¹⁸³ SCM Agreement art. 5.

¹⁸⁴ See SCM Agreement art. 7.8.

“commensurate with the degree and nature of the adverse effects determined to exist, unless the DSB decides by consensus to reject the request.”¹⁸⁵

Article 7.9 of the SCM Agreement is a “special or additional rule and procedure” that “may embody different rules” than Article 22.6 of the DSU.¹⁸⁶ However, the arbitration proceeding under Article 22.6 remains relevant for the determination of the level of countermeasures against actionable subsidies.¹⁸⁷

In practice, the *US – Upland Cotton* case has been the only case where countermeasures against actionable subsidies were requested. Thus, the arbitration in that case is the only WTO interpretation on countermeasures against actionable subsidies.

In order to request countermeasures pursuant to Article 7.9 of the SCM Agreement, three elements have to be taken into consideration: “countermeasures,” “commensurate with the degree and nature,” and “the adverse effects determined to exist.” The distinctive feature of these elements is that, unlike Article 4.11, Article 7.9 explicitly refers to the trade effect approach in determining the level of countermeasures. In the following, I will explain each element in turn.

3.3.3.3.1. Countermeasures

The arbitrators in *US – Upland Cotton (Article 22.6 – US II)* understood the term “countermeasures” under Article 7.9 to mean the same as the term “countermeasures” under Article 4.10. They noted that the term “countermeasures” is another name for retaliation, which is only designated in the SCM Agreement, and it is a measure taken to “act against, or in response to, a failure to remove the adverse effects of, or withdraw, an

¹⁸⁵ SCM Agreement art. 7.9.

¹⁸⁶ *US – Upland Cotton (Article 22.6 – US II)*, *supra* note 150, ¶¶ 4.18-4.19.

¹⁸⁷ *See* SCM Agreement art. 7.10.

actionable subsidy within the required time period.”¹⁸⁸ However, the term “countermeasures,” in and of itself, does not necessarily indicate “an intention to refer to retaliatory action that ‘goes beyond the mere rebalancing of trade interests.’”¹⁸⁹

In addition, they also noted that the term “countermeasures” refers to its meaning in public international law and its nature as defined in the ILC Draft.¹⁹⁰ In this regard, countermeasures are temporary measures that are taken in response to a failure to remove the adverse effects or to withdraw the subsidy within six months after the adoption of the report.

3.3.3.3.2. Commensurate with the Degree and Nature

The permissible level of countermeasures that may be authorized under Article 7.9 is one that is “commensurate with the degree and nature of the adverse effects determined to exist.”

In light of dictionary definitions of the term “commensurate,” the arbitrators in *US – Upland Cotton (Article 22.6 – US II)* noted that it essentially connotes a “correspondence” between countermeasures and “the degree and nature of the adverse effects determined to exist.”¹⁹¹ However, it does not require “exact or precise equality” between the two. In this regard, the arbitrators stated that the term “commensurate” connotes a “less precise degree of equivalence than exact numerical correspondence.”¹⁹²

¹⁸⁸ *US – Upland Cotton (Article 22.6 – US II)*, *supra* note 150, ¶¶ 4.24-4.26.

¹⁸⁹ *Id.* ¶ 4.28.

¹⁹⁰ *See id.* ¶¶ 4.29-4.30.

¹⁹¹ *Id.* ¶¶ 4.35-4.37.

¹⁹² *Id.* ¶ 4.39.

With respect to the terms “degree and nature” of the adverse effects, they noted that these terms may encompass both quantitative and qualitative elements.¹⁹³ As to the “nature” of the adverse effects, it is understood to refer to “the different ‘types’ of adverse effects that are foreseen in Articles 5 and 6, and that this therefore invites a consideration of the specific type of ‘adverse effects’ that have been determined to exist as a result of the specific measure in relation to which countermeasures are being requested.”¹⁹⁴ As to the “degree” of adverse effects, it refers to the “‘extent or scope’ of the adverse effects ‘in terms of their intensity or capacity or potential for causing disruption of markets or trading relationships.’”¹⁹⁵ In assessing the “commensurateness” of the proposed countermeasures to the “degree and nature” of the adverse effects, the arbitrators must consider fully the “degree and nature” of these adverse effects in the case at hand.¹⁹⁶

3.3.3.3. Adverse Effects Determined to Exist

With regard to the “adverse effects determined to exist,” the arbitrators noted that this phrase refers to the “specific ‘adverse effects’ within the meaning of Articles 5 and 6 of the SCM Agreement that form the basis of the underlying findings in the case at hand.”¹⁹⁷ They further noted that, in principle, “the ‘adverse effects determined to exist’ in the underlying proceedings ultimately leading to a request for countermeasures under Article 7.9 of the SCM Agreement may be in the form of injury to the domestic industry of a

¹⁹³ *Id.* ¶ 4.41.

¹⁹⁴ *Id.* ¶¶ 4.42-4.43.

¹⁹⁵ *Id.* ¶ 4.44.

¹⁹⁶ *Id.* ¶ 4.47.

¹⁹⁷ *Id.* ¶ 4.50.

Member, nullification or impairment, or serious prejudice to the interests of another Member.”¹⁹⁸

This is different from countermeasures against prohibited subsidies in the sense that the concept of nullification or impairment is not expressed in Article 4 of the SCM Agreement, whereas Article 5 refers to nullification or impairment as one of three forms of adverse effects with regard to actionable subsidies. This provides a basis for determining the level of countermeasures on the trade effect that produced nullified or impaired benefits.

4. Multilateral Surveillance of Implementation

The DSB shall keep under surveillance the implementation of adopted reports. The issue of implementation shall be placed on the agenda of the DSB meeting after six months following the date of establishment of the reasonable period of time and shall remain on the DSB’s agenda until compliance has been achieved.¹⁹⁹ At least 10 days prior to each DSB meeting, the member concerned shall provide the DSB with a status report in writing of its progress in the implementation of adopted reports.²⁰⁰

In accordance with Article 22.6 of the DSU, the DSB shall also continue to keep under surveillance the implementation of adopted reports where compensation and suspension of concessions or other obligations are in place.²⁰¹

If compliance is found, then, the provision of compensation or the implementation of retaliation will be terminated. With regard to the termination of retaliation, the Appellate

¹⁹⁸ *Id.* ¶¶ 4.51-4.53.

¹⁹⁹ DSU art. 22.6.

²⁰⁰ *See id.*

²⁰¹ DSU art. 22.8.

Body in *EC – Hormones* stated that compliance review under Article 21.5 is appropriate and that the violating member has to “make some showing that it has removed the measure found to be inconsistent” with the DSB recommendations and rulings.²⁰² During the course of review, the retaliating member could maintain its implementation of retaliation.

5. Problems of WTO Dispute Settlement Remedies

There is no doubt that the provision of remedies for violations encouraged WTO members to have confidence in the rules and procedures of WTO dispute settlement. This would be one of the reasons for the high number of complaints brought to the WTO dispute settlement system. In particular, the availability of retaliation improved the status of the WTO as a powerful institution in the international arena. As a remedy of last resort, retaliation can be implemented once the DSB authorizes it. A significant advantage of retaliation is that it is self-implementing in the sense that it does not require bilateral consent from a violating member and, thus, is easy to implement.

In addition, probably the most distinctive feature of retaliation is its threatening nature. Such threats would promote compliance and would probably be more rewarding than the actual imposition of retaliation.²⁰³ For instance, in *Australia – Salmon*, when

²⁰² Appellate Body Report, *Canada – Continued Suspension of Obligations in the EC – Hormones Dispute*, ¶ 362, WT/DS321/AB/R (Oct. 16, 2008).

²⁰³ See Tina Potuto Kimble, *Anticipatory Compliance with WTO rules and the Erosion of U.S. Sovereignty*, 25 *Quinnipiac L. Rev.* 97, 101 (2006); Mark L. Movesian, *Enforcement of WTO Rulings: An Interest Group Analysis*, 32 *Hofstra L. Rev.* 1, 10-11 (2003); William J. Davey, *The World Trade Organization's Dispute Settlement System*, 42 *S. Tex. L. Rev.* 1199, 1207 (2001). However, for critical views on retaliation as a threatening tool, see Marc L. Busch & Eric Reinhardt, *Bargaining in the Shadow of the Law: Early Settlement in GATT/WTO Disputes*, 24 *Fordham Int'l L.J.* 158, 163-164 (2000) (Arguing that the threat of retaliation is not sufficient enough to induce full compliance); Kim Van der Borgh, *The Review of the WTO Understanding on Dispute Settlement: Some Reflections on the Current Debate*, 14 *Am. U. Int'l L. Rev.* 1223, 1232 (1999) (Arguing that the threat of retaliation is ineffective for developing country members).

Australia did not bring its measure into conformity within the reasonable period of time, Canada made a request to the DSB for authorization to impose retaliation an amount of Can \$45 million. Accordingly, Australia brought its measure into compliance by reaching a mutually acceptable solution on implementation.²⁰⁴ In this regard, the threat of retaliation worked as a means for causing the violating member to comply with the WTO rulings.

Nonetheless, despite these advantages of WTO remedies, some have argued that the current remedies contain a number of problems which render them largely ineffective. In the following, I will examine and enumerate a number of problems that WTO remedies currently encounter.

5.1. General Remarks

So to speak, remedies provided in the WTO are not the same as those provided in other areas of law because they do not provide any actual reparation for damages caused by another member's non-compliance.²⁰⁵ WTO remedies are available only when a member does not bring its non-conforming measures into compliance within a reasonable period of time. In other words, if a member brings its measure into compliance within such a period, no further remedies are provided. This is well specified in Article 22.1 of the DSU that both compensation and retaliation are temporary measures and that neither

²⁰⁴ See *Canada Drops Proposal to Retaliate in WTO Salmon Dispute with Australia*, 17 Int'l Trade Rep. (BNA) 1250 (Aug. 10, 2000). The US also lifted its safeguard tariffs on steel when faced with the threat of retaliation by the EC. See Rossella Brevetti & Christopher S. Rugaber, *Bush Ends Steel Safeguard Tariffs in Face of Threat by EU to Retaliate*, 20 Int'l Trade Rep. (BNA) 2021 (Dec. 11, 2003).

²⁰⁵ Some tend to argue that WTO remedies are largely ineffective in the sense that they do not provide actual damages for the complaining member. See, e.g., Gabrielle Kaufmann-Kohler, *Compensation Assessments: Perspectives from Investment Arbitration*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 623 (Chad P. Bown & Joost Pauwelyn eds., 2010); Donald McRae, *Measuring the Effectiveness of the WTO Dispute Settlement System*, 3 Asian J. WTO & Int'l Health L. & Pol'y 1 (2008).

is preferred to full implementation. In this regard, compensation and retaliation are not general remedies for providing actual damages for violation, but temporary remedies for the failure to comply with the WTO rulings.

In the following, I will examine the problems of compensation and retaliation respectively.

5.2. Problems with Compensation

From an economic perspective, compensation is preferred to retaliation in the sense that it is trade liberalizing rather than trade restricting. However, the option of compensation has rarely been used, perhaps owing to the difficulty in determining the level of compensation, i.e., equivalent market access.²⁰⁶

Generally, two problems have been mentioned for the limited use of compensation. They are the voluntary nature of compensation and the application of MFN treatment.

5.2.1. Voluntary Nature

The prominent drawback of compensation is that it is offered only when the disputing members agree on its level and implementation. In other words, the violating member has to agree to provide compensation. According to Article 22.1 of the DSU, it clearly specifies that compensation is voluntary. This voluntary nature makes complaining members prefer retaliation to compensation because, with compensation, it is the violating member that retains control in the sense that it can unilaterally end compensation whenever it believes it has complied with WTO rulings. In contrast, the complaining member can continue to retaliate until the violating member demonstrates

²⁰⁶ See McRae, *supra* note 205, at 9.

compliance to a panel.

Thus, in reality, the use of compensation rarely happens. One additional reason is that the violating member may have difficulty finding a domestic industry sector volunteering for granting, for example, tariff reductions to a competing foreign exporter in order to protect another sector that has benefited from violation. Moreover, in the same context, compensation concerns sectors different from those directly affected by the violation. It does nothing to eliminate the measure that has been found to be in violation.²⁰⁷

5.2.2. In Accordance with MFN Treatment

Although Article 22.1 vaguely states that compensation shall be consistent with the covered agreements, this implies that it must be consistent with MFN treatment in the WTO agreements. According to MFN treatment, “[w]ith respect to customs duties and charges of any kind imposed on or in connection with importation or exportation . . . and with respect to the method of levying such duties and charges,” “any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.”²⁰⁸

Thus, this feature means that, in the case of compensation in the form of tariff reductions on products, not only the complaining member but also any other members exporting the products to the violating member will receive the benefits of compensation. Thus, third members may have the same level of market access as the complaining

²⁰⁷ See David Palmetier & Petros C. Mavroidis, *Dispute Settlement in the World Trade Organization* 266 (2d ed. 2004).

²⁰⁸ GATT art. I:1.

member. In this regard, the violating member may be reluctant to provide compensation because it has to allow a larger degree of market access than if it were to be provided only to the complaining member.²⁰⁹ Conversely, the complaining member may also be reluctant to agree on compensation because its benefits may be dispersed to other members exporting to the violating member when it can instead receive the full benefits of retaliation.²¹⁰

5.3. Problems with Retaliation

A major problem of retaliation is that, while the purpose of the WTO is to minimize the power politics in international relations by introducing a rule-based system, it relies more on a state power to enforce its rules. This may illustrate the inability of the WTO dispute settlement system to provide the remedies of its own. Therefore, in a broad sense, the WTO may deny itself the rule of law.

Most importantly, there are serious concerns on the effectiveness of retaliation in achieving the objective of inducing compliance. Several cases have shown that it was not strong enough to achieve compliance, even though a significant amount of retaliation has been imposed.²¹¹

In the following, I have enumerated a number of problems with retaliation. They are

²⁰⁹ See Kym Anderson, *Peculiarities of Retaliation in WTO dispute Settlement*, 1 World Trade Rev. 123, 126 (2002).

²¹⁰ See Arwel Davies, *Reviewing Disputes Settlement at the World Trade Organization: A Time to Reconsider the Role/s of Compensation*, 5 World Trade Rev. 31, 43 (2006).

²¹¹ The most prominent cases are *EC – Bananas* and *EC – Hormones*. See generally Sebastian Princen, *EC Compliance with WTO Law: The Interplay of Law and Politics*, 15 Euro. J. Int'l L. 555, 569-570 (2004); Benjamin L. Brimeyer, *Bananas, Beef, and Complaine in the World Trade Organization: The Inability of the WTO Dispute Settlement Process to Achieve Compliance from Super Power Nations*, 10 Minn. J. Global Trade 133, 147-163 (2001). For an excellent overview on the problems of retaliation, see Steve Charnovitz, *Should the Teeth be Pulled? An Analysis of WTO Sanctions*, in *The Political Economy of International Economic Law* 602 (D. Kennedy & J. Southwick eds., 2002).

the impediment of free trade, self-hurting nature, incentive to delay compliance, and the unbalanced ability to use retaliation.

5.3.1. Impediment of Free Trade

Retaliation is in the form of suspending concessions, which means adding more trade barriers against foreign imports. Hence, it generally increases restrictions on trade. This seems to be based on the mercantile system, which was based on the premise that exports are economic gains and imports are economic losses.

This proposition may undermine the free trade principle of the WTO by fostering the idea that protecting markets is advantageous. The benefits of free trade are reduced in the sense that retaliation results in a lower level of trade liberalization than the situation where the violation has not been committed.²¹² Moreover, it seems odd for a retaliating member to implement trade restrictions to promote free trade. As Charnovitz correctly points out, “the World Health Organization does not authorize one party to spread viruses to another. The World Intellectual Property Organization does not fight piracy with piracy.”²¹³ It is an interesting paradox that a complaining member is fighting against protectionism by using protectionism.²¹⁴

5.3.2. Self-Hurting Nature

Retaliation has a negative impact not only on the violating member but also, simultaneously, on the complaining member. Because retaliation is meant to raise trade

²¹² I will discuss more on this issue in Chapter 3.

²¹³ Charnovitz, *supra* note 211, at 622. *See also* Asim Imdad Ali, *Non-Compliance and Ultimate Remedies under the WTO Dispute Settlement System*, 14 J. Pub. & Int'l Aff. 5 (2003).

²¹⁴ *See* Sungjoon Cho, *A Dual Catastrophe of Protectionism*, 25 Nw. J. Int'l L. & Bus. 315, 338-341 (2005) (Arguing that protectionism damages free trade); Alan O. Sykes, *Regulatory Protectionism and the Law of International Trade*, 66 U. Chi. L. Rev. 1, 5 (1999) (Arguing that any sort of protectionism is inefficient).

barriers, the consumers and industries of the complaining member, who prefer cheaper imports, have to suffer.²¹⁵ This may be the reason why it has been infrequently used since GATT in keeping with the proposition that retaliation is also detrimental to the interest of the member that does so.²¹⁶ As Dam notes, “it often becomes painfully obvious that no one gains by retaliation.”²¹⁷

In this regard, the complaining member may end up being harmed as much as the violating member. Its consumers will have to pay higher prices for the imported goods concerned or for substitute goods. Businesses that specialize in importing the goods at issue will be particularly hurt. Even, in *EC – Bananas (Ecuador) (Article 22.6 – EC)*, the arbitrators were concerned that retaliation “may also entail, at least to some extent, adverse effects for the complaining party seeking suspension.”²¹⁸

Overall, a complaining member may be dissuaded by the high cost it has to bear for implementing retaliation. The complaining member is required to “shoot oneself in the foot” to do so.²¹⁹

5.3.3. Incentive to Delay Compliance

The level of retaliation is generally determined from the expiration of a reasonable period of time for compliance. In this sense, retaliation is prospective, not retroactive,

²¹⁵ See McGivern, *supra* note 33, at 153; Steve Charnovitz, *Rethinking WTO Trade Sanctions*, 95 Am. J. Int’l L. 792, 809 & 814-815 (2001); Bernard M. Hoekman & Petros C. Mavroidis, *WTO Dispute Settlement, Transparency, and Surveillance*, World Bank 6 (1999); Frider Roessler, *Domestic Policy Objectives and the Multilateral Trade Order: Lessons from the Past*, 19 U. Pa. J. Int’l Econ. L. 513, 528 (1998).

²¹⁶ See Petersmann, *supra* note 15, at 66.

²¹⁷ Kenneth W. Dam, *The GATT: Law and International Economic Organization* 364 (1977). See also Robert W. McGee, *Trade Sanctions as a Tool of International Relations*, 2 Comment. L. & Pub. Pol’y 53 (2004) (Arguing that, in economic terms, all parties are worse off from trade sanctions in international relations).

²¹⁸ *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶ 86.

²¹⁹ Mavroidis, *supra* note 7, at 806.

leaving damages for the past harm uncompensated.²²⁰ Hence, a violating member may enjoy a free ride from the time that the inconsistent measure came into effect until the expiration of the reasonable period of time.

The prospective nature of retaliation has a serious drawback. It gives the violating member a strong incentive to delay compliance by either seeking a long reasonable period of time or resorting to compliance review.²²¹ In other words, it does not have a deterrent effect against potential violators and may encourage foot-dragging in the dispute settlement process.²²² Therefore, the prospective nature of retaliation clearly undermines incentives for prompt compliance.

²²⁰ See Anderson, *supra* note 209, at 129; Joel P. Trachtman, *The WTO Cathedral*, 43 Stan. J. Int'l L. 127, 134 (2007). In a number of cases, panels have noted that retroactive remedies are not common in the WTO dispute settlement system. See, e.g., Panel Report, *United States – Import Measures on Certain Products from the European Communities*, ¶ 6.106, WT/DS165/R (Jul. 17, 2000) (indicating that “[t]here are, however, no explicit DSU provisions providing for retroactive application of retaliatory measures”). In this sense, the WTO enforcement law lacks the remedy of reparation. In a traditional sense, it is significantly different from public international law where it considers both prospective, expected future injuries, and retroactive, past injuries, remedies. See Carlos M. Vazquez & John H. Jackson, *Symposium Issue on WTO Dispute Settlement Compliance: Some Reflections on Compliance with WTO Dispute Settlement Decisions*, 3 Law & Pol’y Int’l Bus. 555 (2002). In addition, retaliation does not help the export industry that has been denied market access by the inconsistent measure of a violating member. Rather, it is the complaining member’s import competing sector that benefits from retaliation. In the sense that retaliation is imposed on sectors that are unrelated to those benefitted from the WTO inconsistency, it does not provide any relief to the industry that was initially injured from the inconsistent measure in the first place. It does not punish the wrongdoer, but instead harms other innocent bystanders. This would be another reason that there is no actual reparation provided in WTO remedies. See Gary N. Horlick, *Problems with the Compliance Structure of the WTO Dispute Resolution Process*, in *The Political Economy of International Economic Law* 636, 641 (D. Kennedy & J. Southwick eds., 2002); Charnovitz, *supra* note 215, at 810-811; Anderson, *supra* note 209, at 130; McGivern, *supra* note 33, at 152. However, I will not address this issue more in detail because the paper mainly focuses on the effectiveness of WTO remedies, not on the private rights of their application.

²²¹ See William J. Davey, *Compliance Problem in WTO Dispute Settlement*, 42 Cornell Int’l L.J. 119, 125 (2009); Horlick, *supra* note 220, at 637; Monika Butler & Heinz Hauser, *The WTO Dispute Settlement System: A First Assessment from an Economic Perspective*, 16 J. L. Econ. & Org. 503, 528 (2000). As of October 31, 2010, WTO members have resorted to compliance review procedures under Article 21.5 of the DSU in 34 out of 117 disputes, or almost 30 per cent of the total cases. See Dispute Settlement Body, *Annual Report (2010), Overview of the State of Play of WTO Disputes, Addendum*, WT/DSB/51/Add.1 (Dec. 3, 2010).

²²² See William J. Davey, *Implementation in WTO Dispute Settlement: An Introduction to the Problems and Possible Solutions* 17 (Ill. Pub. Law & Legal Theory Research Paper Series, Research Paper No. 05-16, 2005), available at <http://ssrn.com/abstract=862786>.

5.3.4. Imbalanced Ability for the Use of Retaliation

Because imposing retaliation is based on a member's economic power, retaliation by a relatively small country member will not likely have a great impact on a large country member. This fact results from the inevitable economic and political inequality between WTO members. In short, retaliation is highly dependent upon the relative economic power of the disputing members. Developing countries have expressed this concern by noting that "the tremendous imbalance in the trade relations between developed and developing countries places severe constraints on the ability of developing countries to exercise their rights" of retaliation.²²³

Thus, in terms of its effectiveness, retaliation is ineffective when a small country member attempts to use it against a large country member because the impact on the latter is negligible.²²⁴ Given a small-sized market, the former will never put enough pressure on the latter. The arbitrators in *EC – Bananas (Ecuador) (Article 22.6 – EC)* noted that Ecuador, a developing country, may find itself in a situation where "it is not realistic or possible for it to implement" retaliation against the EC, a developed country.²²⁵ A small country member may be clearly limited in its ability to use retaliation against a large country member, whereas it may be a very effective instrument for a large country member to use against a small country member.

²²³ Special Session of the Dispute Settlement Body, *Negotiations on the Dispute Settlement Understanding: Special and Differential Treatment for Developing Countries, Proposals on DSU by Cuba, Honduras, India, Indonesia, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe*, 1, TN/DS/W/19 (Oct. 9, 2002) [hereinafter Developing Countries' Proposal].

²²⁴ See Charnovitz, *supra* note 211, at 625-626; Richard H. Steinburg, *In the Shadow of Law or Power? Consensus-Based Bargaining and Outcomes in the GATT/WTO*, 56 Int'l Org. 339, 347 (2002). See also Chad P. Bown & Bernard M. Hoekman, *Developing Countries and Enforcement of Trade Agreements: Why Dispute Settlement Is Not Enough* (World Bank Pol'y Research Working Paper Series, Paper No. 4450, 2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1077482; Chad P. Bown & Bernard M. Hoekman, *WTO Dispute Settlement and the Missing Developing Country Cases: Engaging the Private Sector*, 8 J. Int'l Econ. L. 861, 862 (2005); Mavroidis, *supra* note 7, at 807.

²²⁵ *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶ 177.

Furthermore, in the sense that small country members are generally trade dependent, retaliation would have an adverse impact because it is essentially an exclusion of foreign imports. In *US – Gambling (Article 22.6 – US)*, Antigua was concerned that the imposition of retaliation on products or services from the US would have a “disproportionate adverse impact on Antigua by making these products and services materially more expensive to the citizens of the country.”²²⁶ Given the economic inequality between the US and Antigua, retaliation would have a “much greater negative impact on Antigua than it would on the United States.”²²⁷ In addition, small country members may be reluctant to retaliate against large country members because they may fear counter-retaliation in non-WTO areas such as development aid.²²⁸ Overall, in a broad sense, this may be one of a number of reasons that deter small country members from seeking recourse to the WTO dispute settlement system.²²⁹

III. Conclusion

In this Chapter, I examined the rules and procedures of remedies in the WTO dispute settlement system. Prior to this examination, I discussed the rules and procedures of

²²⁶ *US – Gambling (Article 22.6 – US)*, *supra* note 92, ¶ 4.2.

²²⁷ *Id.* See also Amin Alavi, *African Countries and the WTO’s Dispute Settlement Mechanism*, 25 Dev. Pol’y Rev. 25, 34 (2007) (Arguing that small country members cannot meaningfully retaliate because the losses would be more than the possible gains); Jeffrey Waincymer, *World Trade Organization Litigation: Procedural Aspects of Formal Dispute Settlement* 659 (2002). Furthermore, even when they are faced with retaliation, they will be also hurt because it is essentially the exclusion of access to foreign markets. See Henrik Horn & Petros C. Mavroidis, *Remedies in the WTO Dispute Settlement System and Developing Country Interest* (Report Commission by the World Bank, 1999).

²²⁸ See Joost Pauwelyn, *Enforcement and Countermeasure in the WTO: Rules are Rules - Toward a More Collective Approach*, 94 Am. J. Int’l L. 335, 338 (2000).

²²⁹ See Rossella Brevetti, *Small Economies Do not Get Fair Shake in WTO Dispute Settlement*, Attorney Says, 26 Int’l Trade Rep. (BNA) 446 (Apr. 2, 2009). However, Nottage argues that the shortcomings of retaliation for developing members are not decisive factors that discourage them to utilize the WTO dispute settlement system. See Hunter Nottage, *Evaluating the Criticism that WTO Retaliation Rules undermine the Utility of WTO Dispute Settlement for Developing Countries*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 319 (Chad P. Bown & Joost Pauwelyn eds., 2010).

remedies in the pre-WTO dispute settlement system in order to achieve a broader view of WTO dispute settlement remedies. Such discussion seems very meaningful in the sense that it provided better understanding of the evolvement and conversion of WTO remedies.

In the pre-WTO dispute settlement system, GATT, guidance on the rules and procedures of remedies was very minimal. Moreover, problems existed in terms of implementation. The losing party could block not only the adoption of a panel report but also the authorization of retaliation. Parties retained their legal authority and, often, chose to enforce their own domestic laws, disregarding the remedy procedure under GATT.

In contrast, the WTO provides much more detailed rules and procedures of remedies. Unlike GATT, the dispute settlement procedure was incorporated into a single text, the DSU, in order to provide a concrete framework. The DSU specified a strict time frame on every procedural stage in order to promote prompt compliance with WTO rulings. The rule of “reverse-consensus” decision-making resolved the problem surrounding the blockage of the adoption of legal rulings and the authorization of retaliation.

In terms of the effectiveness of remedies, the WTO introduced the option of cross-retaliation and required an “equivalent” level of retaliation which is a stricter concept than an “appropriate” level of retaliation under GATT. It also clearly distinguished the countermeasures against prohibited or actionable subsidies from retaliation under the DSU. In this regard, a clear set of rules and procedures on remedies made members more willing to have recourse to the WTO dispute settlement system.

However, an examination of the current system of WTO remedies revealed a number of problems. With regard to compensation, its voluntary nature and the application of MFN treatment makes the use of compensation infrequent. With regard to retaliation, it

increases restrictions on trade which may undermine the free trade principle of the WTO. It is self-inflicted harm in the sense that the consumers and industries of the complaining member, who prefer cheaper imports, have to suffer. There is also a problem with free riding by a violating member because the level of retaliation is generally determined from the expiration of the reasonable period of time, which ultimately provides an incentive to delay compliance. Further, since retaliation is based on a member's economic power, it may be ineffective when a small country member attempts to impose it against a large country member.

In this Chapter, I provided a general overview of WTO dispute settlement remedies and examined the problems associated with this system. By doing so, I provided the framework for understanding the purpose of this dissertation. The remedies available through the WTO dispute settlement process must be improved significantly in order for the WTO to operate effectively and to build its credibility and strong commitment.

CHAPTER 3: THE PURPOSE OF WTO DISPUTE SETTLEMENT REMEDIES

This Chapter attempts to clarify the purpose of WTO dispute settlement remedies. It is an essential prerequisite for designing effective remedies because different aims may require completely different remedies.

The purpose of remedies under public international law seems quite clear. Article 49.1 of the ILC Draft provides that “[a]n injured State may only take countermeasures against a State which is responsible for an internationally wrongful act in order to induce that State to comply with its obligations” Thus, remedies clearly aim at inducing compliance. However, the purpose of WTO dispute settlement remedies is not explicitly provided in any of WTO agreements. WTO arbitrators sometimes have found difficulties in determining the level of retaliation without having a proper understanding of what WTO remedies are aimed at. They have expressed their concern by stating that they are not “completely clear what role is to be played by the suspension of obligations in the DSU and a large part of the conceptual debate that took place in these proceedings could have been avoided if a clear ‘object and purpose’ were identified.”²³⁰

Unfortunately, the uncertainty and confusion on the purpose of remedies has created controversy. One view tends to posit that the purpose of WTO remedies is to induce compliance. This view is deeply rooted in the discipline of public international law where countries are under a strict obligation to comply with their commitments.²³¹ Thus, for proponents of this view, there is no option to breach and provide compensation in lieu of

²³⁰ Decision of the Arbitrator, *United States – Continued Dumping and Subsidy Offset Act of 2000, Recourse to Arbitration by the United States under Article 22.6 of the DSU*, ¶ 6.4, WT/DS234/ARB/CAN (Aug. 31, 2004) [hereinafter *US – Offset Act (Byrd Amendment) (Canada) (Article 22.6 – US)*].

²³¹ This comes from the rule of *pacta sunt servanda*. Article 26 of the Vienna Convention on Law of Treaties reads that “[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith.” Vienna Convention on Law of Treaties art. 26, May 23, 1969, 8 I.L.M. 679.

complying with WTO agreements (hereinafter “compliance advocates”).²³² Another view, on the other hand, tends to posit that the purpose of WTO remedies is to restore the balance of the trading relationship. It is deeply rooted in the discipline of law and economics and argues that, by equilibrating the mutual balance, a violating member may be relieved from its commitment if it offers adequate compensation, providing an efficient opt-out possibility. Thus, this view is completely contrary to the view of compliance advocates in the sense that it does not require a violating member to comply with WTO agreements (hereinafter “rebalancing advocates”).²³³

This Chapter attempts to resolve this controversy by determining the true purpose of

²³² See generally Thomas Jurgensen, *Crime and Punishment: Retaliation under the World Trade Organization Dispute Settlement System*, 39 J. World Trade 327 (2005); Jide Nzelibe, *The Credibility Imperative: The Political Dynamics of Retaliation in the World Trade Organization's Dispute Resolution Mechanism*, 6 Theoretical Inq. L. 215 (2005); Joost Pauwelyn, *Remedies in the WTO: First Set the Goal, then Fix the Instruments to Get There*, in WTO Law and Process 185 (Mads Tonnesson Andenas & Federico Ortino eds., 2005); John H. Jackson, *International Law Status of WTO Dispute Settlement Reports: Obligations to Comply or Option to “Buy Out”?*, 98 Am. J. Int'l L. 109 (2004) [hereinafter Jackson 2004]; Steve Charnovitz, *The WTO's Problematic “Last Resort” Against Noncompliance*, 57 Aussenwirtschaft 409 (2002); Akira Kotera, *On the Legal Character of Retaliation in the World Trade Organization System*, in 2 Liber Amicorum Judge Shigeru Oda 911 (Nisuke Ando, Edward McWhinney & Rudiger Wolfrum eds., 2002); McGivern, *supra* note 33; John H. Jackson, *The WTO Dispute Settlement Understanding – Misunderstandings on the Nature of Legal Obligations*, 91 Am. J. Int'l L. 60 (1997) [hereinafter Jackson 1997].

²³³ See generally Alan O. Sykes, *Optimal Sanctions in the WTO: The Case for Decoupling (and the Uneasy Case for the Status Quo)*, in The Law, Economics and Politics of Retaliation in WTO Dispute Settlement 339 (Chad P. Bown & Joost Pauwelyn eds., 2010) [hereinafter Sykes 2010]; David Palmeter & Stanimir A. Alexandrov, *“Inducing Compliance” in WTO Dispute Settlement*, in The Political Economy of International Economic Law 646 (D. Kennedy & J. Southwick eds., 2002); Warren F. Schwartz & Alan O. Sykes, *The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization*, 31 J. Legal Stud. S179 (2002); Anderson, *supra* note 209; David Palmeter, *The WTO Dispute Settlement Mechanism, Compliance with WTO Rulings and Other Procedural problems*, 4 J. World Intell. Prop. 291 (2001); Alan O. Sykes, *The Remedy for Breach of Obligations under the WTO Dispute Settlement Understanding: Damages or Specific Performance?*, in New Directions in International Economic Law 347 (Marco Bronckers & Reinhard Quick eds., 2000) [hereinafter Sykes 2000]; Judith Hippler Bello, *The WTO Dispute Settlement Understanding: Less is More*, 90 Am. J. Int'l L. 416 (1996). However, for the views of asserting both purposes, see Reto Malacrida, *Towards Sounder and Fairer WTO Retaliation: Suggestions for Possible Additional Procedural Rules Governing Members' Preparation and Adoption of Retaliatory Measures*, 42 J. World Trade 3 (2008); Tim Josling, *WTO Dispute Settlement and the EU-US Mini Trade Wars: A Commentary on Fritz Breuss*, 4 J. Industry, Competition & Trade 337 (2004); Ichiro Araki, *Comment on Fritz Breuss “WTO Dispute Settlement: An Economic Analysis of Four EU-US Mini Trade Wars,”* 4 J. Industry, Competition & Trade 345 (2004); M. Rafiqul Islam, *Recent EU Trade Sanctions on the US to Induce Compliance with the WTO Ruling in the Foreign Sales Corporations Case: Its Policy Contradiction Revisited*, 38 J. World Trade 471 (2004).

WTO remedies, so as to allow more effective remedies to be designed, a task I undertake in the following Chapter. I have examined the purpose from historical, contractual and practical perspectives.

I. The Purpose of WTO Remedies from a Historical Perspective

One method of discerning the purpose is by looking at WTO remedies from a historical perspective. In this Section, I will examine the historical background of WTO remedies, drawing particular attention to their conceptual and structural evolution.

1. Conceptual Evolution of WTO Remedies

GATT was mainly concerned with maintaining the balance of tariff concessions between contracting parties. Contracting parties negotiated for their market access rights. By reducing their trade barriers, they received increased access to other parties' markets in return. Thus, they were willing to permit access to their market only in exchange for equivalent access to other parties' markets.²³⁴

²³⁴ See Robert E. Hudec, *The GATT Legal System: A Diplomat's Jurisprudence*, 4 J. World Trade 615, 616-636 (1970) (Arguing that GATT negotiations were mainly to ensure the reciprocal balance of concessions which has been considered as one of the major goals of dispute settlement). Restoring balances has been also recognized in the Havana Charter. "The Charter . . . recognizes that [new protective measures] may upset the balance of mutual advantage that was established when the original contractual relationships were entered into. In conformity with the guiding principle that when this happens means should be found to restore the balance, it provides a remedy." William Adams Brown, Jr., *The United States and the Restoration of World Trade: An Analysis and Appraisal of the ITO Charter and the General Agreement on Tariffs and Trade* 205 (1950). Wilcox also noted that:

[T]he possibility of suspending trade concessions under this procedure was regarded as a method of restoring a balance of benefits and obligations that, for any reason, may have been disturbed. It is nowhere described as a penalty to be imposed on members who may violate their obligations or as a sanction to insure that these obligations will be observed.

But even though it is not so regarded, it will operate in fact as a sanction and a penalty. Clair Wilcox, *A Charter for World Trade* 159 (1949). The idea of restoring balances could be found in a number of GATT articles. Under Article XIX, a member may impose protectionist safeguards when increased competition from imports causes or threatens domestic industry. If no satisfactory compensation is agreed upon, in response, the affected member may withdraw concessions that are substantially equivalent to the lost exports. Under Article XXVIII, a member may modify its tariff concessions. Again, if

However, whenever this balance is upset, it nullifies or impairs the benefits that had been previously negotiated. In this regard, the violations of these commitments were “considered serious not because they were violations but because a subtle balance of tariff concessions would be destroyed.”²³⁵ Thus, the original format of remedies under GATT was intended to restore the balance of benefits that contracting parties had negotiated in the first place.

Dam confirmed that “the consequence of nonperformance is . . . merely the reestablishment, at the option of an interested party . . . of the preexisting situation.”²³⁶ Long also confirmed that the purpose of remedies is “not to penalize a breach of the rules,” but “to restore, with the minimum interference with trade, the balance of concessions and advantage between the parties [to a] dispute.”²³⁷ He further argued that it should not mean more than “the re-establishment of the balance of concessions and advantage between member countries. Similarly, action by the Contracting Parties authorizing retaliatory measures does not take the form of a legal sanction. What is sought is a restoration of the balance upset by one of the member countries.”²³⁸

More recently, Hudec confirmed the views of both Dam and Long by stating that “[t]he official purpose of all retaliatory measures is to maintain the balance of reciprocity that has been upset. All GATT retaliation is limited to a ‘compensatory’ amount – that is, an amount equivalent to the value of the trade obligation being nullified or impaired by the other party.”²³⁹

negotiation breaks down, the member affected by such modifications may withdraw substantially equivalent concessions. Hence, both articles are aimed at rebalancing rather than rule enforcement.

²³⁵ Cho, *supra* note 33, at 766.

²³⁶ Dam, *supra* note 217, at 78.

²³⁷ Long, *supra* note 15, at 66.

²³⁸ *Id.* at 78.

²³⁹ Robert E. Hudec, *GATT Legal Restraints on the US of Trade Measures against Foreign Environmental*

Thus, in case of violations, the purpose of GATT remedies under Article XXIII was to restore the balance of benefits between the parties to a dispute by providing for compensatory adjustment.²⁴⁰ With regard to the provisions that correspond to Article XXIII of GATT, the report of the Sixth Committee of the Interim Commission for the ITO stated that the nature of remedies is not punitive and the “term ‘appropriate’ . . . should not be read to provide relief for beyond compensation.”²⁴¹

The purpose of remedies under the WTO seems not all that different from GATT. The WTO agreements are also created through a series of negotiations requiring members to exchange concessions. The preamble of the Agreement Establishing the World Trade Organization explicitly confirms that parties desire to achieve these objectives “by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations.”²⁴²

Thus, as was the case with GATT, in case of violations, the purpose of WTO remedies is also to restore the reciprocal balance of benefits between the parties to a dispute. Pauwelyn states that:

What is actionable under the WTO is not so much the breach of obligation, but the upsetting of the negotiated balance of benefits consisting of rights,

Practices, in 2 Fair Trade and Harmonization 100 (Jagdish Bhagwati & Robert E. Hudec eds., 1996).

²⁴⁰ See Jackson, *supra* note 33, at 170-171. For an economic analysis of rebalancing, see Chad P. Bown, *On the Economic Success of GATT/WTO Dispute Settlement*, 86 Rev. Econ. & Stat. 811 (2004); Chad P. Bown, *The Economics of Trade Disputes, The GATT's Article XXIII, and the WTO's Dispute Settlement Understanding*, 14 Econ. & Pol. 283, 288 (2002).

²⁴¹ Secretariat of the Interim Commission for the International Trade Organization, Havana, Nov. 21, 1947-Mar. 24, 1948, *Reports of Committees and Principal Subcommittees of the United Nations Conference on Trade and Employment*, 155, U.N. Doc. ICITO I/8 (1948), available at www.wto.org/gatt_docs/English/SULPDF/90180096.pdf.

²⁴² Marrakesh Agreement Establishing the World Trade Organization, Preamble, Apr. 15, 1994, Legal Instruments – Results of the Uruguay Round, 33 I.L.M. 1144 (1994) [hereinafter WTO Agreement].

obligations, and additional trade concessions. This approach directly parallels that of GATT . . . Even though . . . rebalancing the scales is, within the WTO, stated to be only a temporary solution.²⁴³

Along with the purpose of rebalancing, however, there was another purpose to be considered in providing dispute settlement remedies. In the transition period from GATT to the WTO, the global trading community began to be more interested in preserving a legal system. Perhaps, the explosion of non-tariff entitlements such as public morals, human health, the environment, government procurement, and subsidies called for a more judicial system in the determination of non-compliance in order to protect these entitlements. While GATT was more of the reciprocal exchanges of tariff concessions through contractual negotiations, the WTO is a rule-oriented international trade regime that produces a set of rules and legal norms.²⁴⁴ It is something greater than a mere contract where parties are only bilaterally bound. The WTO is rather an independent international organization established by its members to “multilateralize” and integrate a legal system for international trade that contains its own adjudicative system to manage

²⁴³ Pauwelyn, *supra* note 228, at 339-340. *See also* Holger Spamann, *The Myth of ‘Rebalancing’ Retaliation in WTO Dispute Settlement Practice*, 9 J. Int’l Econ. L. 31, 42 (2006) (Arguing that “the deterrence aim alone could not explain *any* upper limit on retaliation”). Based on the Bagwell and Staiger’s reciprocity theory, Bown and Ruta assessed that the complainant is allowed to introduce a retaliatory measure, i.e., a trade restrictive measure, “that is designed to stabilize the value of export and import trade volumes between countries.” In their economic assessment of the ten arbitration reports, they concluded that the actual approach of the arbitrators appears quite consistent with the Bagwell and Staiger theory of the “reciprocity approach.” *See* Chad P. Bown & Michele Ruta, *The Economics of Permissible WTO Retaliation*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 149, 153-156 (Chad P. Bown & Joost Pauwelyn eds., 2010). *See also* Kyle Bagwell & Robert W. Staiger, *The Economics of the World Trading System* 57-69 (2004); Jagdish Bhagwati, *Introduction: The Unilateral Freeing of Trade Versus Reciprocity*, in *Going Alone: The Case for Relaxed Reciprocity in Freeing Trade* 1, 10-12 (Jagdish Bhagwati ed., 2002). For a general understanding of reciprocity in international law, see Robert Axelrod, *The Evolution of Cooperation* 136-139 (1984) (Stating that reciprocity is the best strategy for inducing cooperation among egotistical actors); Ernst Schneeberger, *Reciprocity as a Maxim of International Law*, 37 Geo. L. J. 34, 38 (1948) (Noting that reciprocity is one of the basic principles of international law).

²⁴⁴ *See* Jackson 2004, *supra* note 232, at 121 (He further states that “[t]his drive to completing the contract is interpreted as a paradigm shift away from reciprocity and rebalancing, and towards a fully legalized ‘trade constitution’”). *See also* Debra P. Steger, *Afterword: The Trade and ... Conundrum – A Commentary*, 96 Am. J. Int’l L. 135, 137-138 (2002).

disputes among contracting members.²⁴⁵ Thus, the WTO began to put more weight on the violation itself rather than injuries, i.e., nullification or impairment. In this context, Article 3.8 of the DSU provides that where the WTO agreement has been violated, there is a presumption of nullification or impairment. It also provides the possibility of a violating member to rebut that presumption. However, in practice, none of the violating members have been successful in providing sufficient evidence to set aside the presumption that complaining members have suffered nullification or impairment; indeed, few have even tried to rebut the presumption.²⁴⁶

Overall, the additional (or maybe essential) purpose of WTO remedies seems to be to end violations by inducing the violating member to comply with its obligations. Therefore, along with the purpose of rebalancing the reciprocal benefits of the parties to a dispute, the legal transformation toward enforcement adds the purpose of inducing compliance to WTO remedies.

²⁴⁵ See Steve Charnovitz, *Judicial Independence in the World Trade Organization*, in *International Organizations and International Dispute Settlement: Trends and Prospects* 219, 219-240 (Laurence Boisson de Chazournes, Cesare Romano & Ruth Mackenzie eds., 2002). Iwasawa points out a number of procedural aspects of adjudication in the WTO. In his article, he notes that:

Panel procedures in the WTO resemble adjudication in the following respects: an applicant has a right to be heard by a panel; parties present their case in writing and orally in a legal manner; third parties can intervene in the proceedings; the panel makes legal findings based on law; the panel uses various legal techniques in reaching findings (e.g., burden of proof, methods of interpretation, respect for precedents); the parties may appeal the case to the Appellate Body; the report is adopted virtually automatically; and the adopted report binds the parties ... Panel procedures are definitely adjudicatory in this sense because, ... reports of panels and the Appellate Body bind the parties.

Yuji Iwasawa, *WTO Dispute Settlement as Judicial Supervision*, 5 J. Int'l Econ. L. 287, 290 (2002). See also Juscelino F. Colares, *A Theory of WTO Adjudication: From Empirical Analysis to Biased Rule Development*, 42 Vand. J. Transnat'l L. 383 (2009); Alberto Alvarez-Jimenez, *The WTO Appellate Body's Decision-Making Process: A Perfect Model for International Adjudication?*, 12 J. Int'l Econ. L. 289 (2009); Leah Granger, *Explaining the Broad-Based Support for WTO Adjudication*, 24 Berkeley J. Int'l L. 521 (2006); Joseph H. H. Weiler, *The Rule of Lawyers and the Ethos of Diplomats – Reflections on the Internal and External Legitimacy of WTO Dispute Settlement*, 35 J. World Trade 191 (2001).

²⁴⁶ See, e.g., Panel Report, *Argentina – Definitive Anti-Dumping Measures on Imports of Ceramic Floor Tiles from Italy*, ¶¶ 6.103-6.105, WT/DS189/R (Sept. 28, 2001); Panel Report, *Turkey – Restrictions on Imports of Textile and Clothing Products*, ¶ 9.204, WT/DS34/R (May 31, 1999); Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, ¶¶ 251-253, WT/DS27/AB/R (Sept. 9, 1997).

2. Structural Evolution of WTO Remedies

There has been a structural evolution of remedies from GATT to the WTO. First, the binding nature of WTO decisions has been enhanced in the direction of bringing an inconsistent measure into compliance. Second, the procedure on remedies has been advanced towards a compliance-inducing mechanism. I will explain this in more detail in the following.

2.1. Binding Nature of WTO Decisions

Generally, if a court's decision is meant to be binding, it implies that a court imposes a legal obligation on the violating party to comply with its order. In this regard, in order for a decision of the WTO adjudicatory system to be binding, it has to impose a legal obligation on the violating member to comply with its rulings.²⁴⁷ Historically, it has been at least from the last two decades of the GATT era that panel reports were considered as legally binding between the parties of a dispute.²⁴⁸

Then, what are the binding decisions that the GATT/WTO dispute settlement system issues and makes? In the WTO, after making “an objective assessment of the facts of the

²⁴⁷ See W. M. Reisman, *The Enforcement of International Judgments*, 63 Am. J. Int'l L. 1, 26 (1969) (Stating that “[e]ffective law . . . depends upon predispositions among an effective majority of participants towards compliance with authority”). In the international setting, a binding decision of a court makes its remedies more effective because it will increase the reputational cost and generate domestic law pressure to comply. See Andrew T. Guzman, *International Tribunals: A Rational Choice Analysis*, 157 U. Pa. L. Rev. 171, 189-192 (2008). For an explanation on the reputational effect of compliance in international law, see Andrew T. Guzman, *Reputation and International Law*, 34 Ga. J. Int'l & Comp. L. 379 (2006); Andrew T. Guzman, *The Promise of International Law*, 92 Va. L. Rev. 533 (2006); Andrew T. Guzman, *A Compliance-Based Theory of International Law*, 90 Cal. L. Rev. 1823 (2002). However, for critical views, see Rachel Brewster, *Unpacking the State's Reputation*, 50 Harv. Int'l L.J. 231 (2009); Jack L. Goldsmith & Eric A. Posner, *The Limits of International Law* (2005); Colin B. Picker, *Reputational Fallacies in International Law: A Comparative Review of United States and Canadian Trade Actions*, 30 Brook. J. Int'l L. 67 (2004); George W. Downs & Michael A. Jones, *Reputation, Compliance, and International Law*, 31 J. Legal Stud. S95 (2002).

²⁴⁸ See generally John H. Jackson, *The Legal Meaning of a GATT DS Report: Some Reflections*, in 1 *Toward More Effective Supervision by International Organizations* 149 (Niels Blokker & Sam Muller ed., 1994).

case and the applicability of and conformity with the relevant covered agreements,” a panel issues a report which is subsequently adopted by the DSB.²⁴⁹ The report of the Appellate Body is also adopted in the same manner. In their reports, when a measure in question is found to be inconsistent with WTO agreements, a panel or the Appellate Body recommends that the member concerned bring its measure into conformity with its rulings.²⁵⁰ Thus, a violating member has to comply with the WTO ruling, which is to implement the recommendations of a panel and the Appellate Body.²⁵¹

There are at least two reasons that support the view of the binding nature of such recommendations. First, a number of cases have confirmed the binding nature of adopted reports. In *Japan – Alcoholic Beverages*, the Appellate Body recognized that adopted panel reports are binding on the parties to a dispute.²⁵² In *US – Shrimp*, the Appellate Body confirmed that its report shall be “unconditionally accepted by the parties to the dispute.”²⁵³ In *EC – Bed Linen*, the Appellate Body acknowledged that the reports of both panels and the Appellate Body must be “treated as a *final resolution* to a dispute between the parties to that dispute.”²⁵⁴

²⁴⁹ See DSU art. 11 & 16.

²⁵⁰ See DSU art. 19.1. There is an ambiguity on which body provides the “recommendation.” Fukunaga, however, notes that “the panel and Appellate Body reports, particularly their conclusions and recommendations, form the basis of the DSB recommendations. In this respect only, the legal effects of the DSB recommendations and those of the panel and Appellate Body reports could be discussed interchangeably.” Yuka Fukunaga, *Securing Compliance through the WTO Dispute Settlement System: Implementation of DSB Recommendations*, 9 J. Int’l Econ. L. 383, 395 n.44 (2006).

²⁵¹ In GATT, the CONTRACTING PARTIES were authorized to make recommendations or give rulings on the dispute. However, it commonly adopted a panel report without making additional recommendations or rulings.

²⁵² See Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, ¶ 97, WT/DS8/AB/R, WT/DS10/AB/R & WT/DS11/AB/R (Oct. 4, 1996) [hereinafter *Japan – Alcoholic Beverages*]. See also Panel Report, *India – Measures Affecting the Automotive Sector*, ¶ 7.58, WT/DS146/R & WT/DS175/R (Dec. 21, 2001).

²⁵³ *US – Shrimp*, *supra* note 73, ¶ 97. Article 17.14 of the DSU also provides that “[a]n Appellate Body report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute”

²⁵⁴ Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen From India, Recourse to Article 21.5 of the DSU by India*, ¶¶ 90-93, WT/DS141/AB/RW (Apr. 8, 2003) (emphasis original).

Second, the DSU provides several mechanisms for ensuring the implementation of recommendations. Under Article 19.1, “the panel or the Appellate Body may suggest ways in which the Member concerned could implement the recommendations.” Although these suggestions do not seem to be binding, it is expected to provide the member concerned with some guidance for implementing the recommendations. Under Article 21.3(c), when it is impracticable to comply immediately with the recommendations, the members concerned may request an arbitration to determine “the reasonable period of time to implement panel or Appellate Body recommendations.” This arbitration is expected to specify the time period for implementation and, thus, to prevent deliberate delays in compliance. Under Article 21.5, “[w]here there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel.” This procedure is expected to determine whether the member concerned has complied with WTO recommendations.²⁵⁵

In this regard, the recommendations of panels and the Appellate body are widely acknowledged as legally binding.²⁵⁶ A member, whose measures have been found to be

²⁵⁵ This is unique in the sense that there are no such procedures in any other legal system including domestic judicial organs. It is, as a matter of judicial economy, to avoid the initiation of a new proceeding and to facilitate the implementation of recommendations. This is aimed at promoting and encouraging a violating member to better comply with its obligations.

²⁵⁶ See generally Andreas F. Lowenfeld, *International Economic Law* 156 (2002); Hudec, *supra* note 22, at 377; Jackson 2004, *supra* note 232, at 115-117; Jackson 1997, *supra* note 232, at 62-63. Furthermore, adopted reports establish an obligation under public international law upon the violating member to bring its measure into conformity with WTO rulings. The Appellate Body made it clear that the WTO is not a regime that exists in isolation, but deeply rooted in the scheme of public international law. See Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, ¶ 17, WT/DS2/AB/R (Apr. 29, 1996). However, for critical views on the binding nature of recommendations, see Joel P. Trachtman, *Bananas, Direct Effect and Compliance*, 10 Eur. J. Int’l L. 655, 660 (1999) (Arguing that, due to the lack of direct effect in the WTO which provides some sort of “political filter” for adopting panel decisions, the binding force of the WTO is not complete); Timothy M. Reif & Marjorie Florestal, *Revenge*

in violation, has a legal obligation to implement such recommendations.

However, some tend to misunderstand that the lack of enforceability makes law non-binding and, thus, there is no legal obligation for members to comply with WTO recommendations.²⁵⁷ In the late 90's, Bello, who initially triggered the debate on the purpose of WTO remedies, argued that:

Like the GATT that preceded them, the WTO rules are simply not “binding” in the traditional sense. When a panel established under the WTO Dispute Settlement Understanding issues a ruling adverse to a member, there is no prospect of incarceration, injunctive relief, damages for harm inflicted or police enforcement. The WTO has no jailhouse, no bail bondsmen, no blue helmets, no truncheons or tear gas.

Rather, the WTO-essentially a confederation of sovereign national

of the Push-Me, Pull-You: The Implementation Process under the WTO Dispute Settlement Understanding, 32 Int'l Law. 755, 762-763 (1998) (Arguing that the DSU does not provide explicit language imposing a strict obligation of compliance).

²⁵⁷ The debate goes back to the question of why states do comply (or not comply) with international law. Of course, the question of compliance is not entirely new in the discipline of public international law. This issue has been studied for quite a long time, but there is no agreement on what would be an effective compliance mechanism. The difficulty on agreeing on such a mechanism is due to the bifurcated views on compliance. Realists argue that states will comply only when it is in their best interest. See Hans J. Morgenthau & K. W. Thompson, *Politics among Nations* (6th ed. 1960); Hans J. Morgenthau, *Positivism, Functionalism, and International Law*, 34 Am. J. Int'l L. 260 (1940); E. H. Carr, *Twenty Years' Crisis 1919-1939: An Introduction to the Study of International Relations* (1940). On the other hand, some argue that states normally comply with international law because it is in their interest and worthy of adherence. See Louis Henkin, *How Nations Behave* (1961) (Asserting that “almost all nations observe almost all principles of international law almost all of the time”); Abram Chayes & Antonia Handler Chayes, *The New Sovereignty: Compliance with International Regulatory Agreements* (1995) (Arguing that obeying international law is a widely held social norm). With regard to the debate, a number of suggestions have been made for enhancing compliance. One is that, if a deeper level of cooperation is required, a coercive enforcement mechanism would be necessary despite states' intention to voluntarily comply with international law. See George W. Downs, David M. Rocke & Peter N. Barsoom, *Is the Good News About Compliance Good News About Cooperation?*, 50 Int'l Org. 379, 397-399 (1996). In contrast, Chayes and Chayes argued that coercive mechanisms such as sanctions are “waste of time.” Rather, they should be replaced with a “managerial model” which manages and eliminates the ambiguity of the agreement and the lack of state's capacity to comply. See Chayes & Chayes, *supra* note 257. See also Abram Chayes & Antonia Handler Chayes, *On Compliance*, 47 Int'l Org. 175 (1993). For a compromised view, see Oran R. Young, *Compliance and Public Authority: A Theory with International Applications* (1979) (Combining both enforcement and management technique to enhance compliance). See also Thomas M. Franck, *Fairness in International Law and Institutions* (1995); Thomas M. Franck, *The Power of Legitimacy Among Nations* (1990) (Arguing that states comply with international law because of legitimacy and fairness); Harold Hongju Koh, *Why Do Nations Obey International Law?*, 106 Yale L. J. 2599 (1997) (Arguing that the “transnational legal process” would be required in norm internalization to enhance compliance).

governments-relies upon voluntary compliance.²⁵⁸

Of course, the existing methods for dealing with WTO violations may not always be very effective. However, the fact that the WTO lacks a centralized political authority to enforce DSB recommendations does not mean that they are not binding. The lack of enforceability in the WTO is a different issue from the question of whether WTO obligations are binding in nature. So to speak, the weakness and ineffectiveness of remedies in the WTO cannot deny the nature of the legal binding power of the WTO adjudicatory system.²⁵⁹

2.2. Procedural Evolution of WTO Remedies

There are a number of remedy procedures in the WTO dispute settlement system that can be characterized as compliance-inducing mechanisms. First, the WTO has compulsory jurisdiction over a dispute. The DSU explicitly provides that a member shall not make a determination that a violation has occurred “except through recourse to dispute settlement in accordance with the rules and procedures of this understanding.”²⁶⁰ Thus, a member can complain only through the process of consultation, followed by panel and Appellate Body proceedings, that the WTO dispute settlement system provides. In GATT, consensus was required for the CONTRACTING PARTIES to establish a panel. And even after the establishment, consensus was also required for the adoption of

²⁵⁸ Bello, *supra* note 233, at 416-417. In response, see Jackson 1997, *supra* note 232 at 63-64 (Asserting that, based on the DSU articles, there is a strong preference for each member to comply with WTO rulings).

²⁵⁹ Although international law seems to have weak enforcement mechanisms compared to those in domestic law, the legal obligation of international law may have direct application, and, to a certain extent, direct effects. See Thomas Cottier, *Dispute Settlement in the World Trade Organization: Characteristics and Structural Implications for the European Union*, 35 Common Mkt. L. Rev. 325, 373-375 (1998). See also Harold Hongju Koh, *Transnational Legal Process*, 75 Neb. L. Rev. 181 (1996).

²⁶⁰ See DSU art. 23.2 (a).

a panel. Thus, a ruling was not binding until both parties had accepted it. However, a reverse-consensus rule has been adopted in the WTO to prevent this blockage. The consent of the violating member to establish a panel is no longer required.²⁶¹ It can neither block the case nor reject the reports. Thus, the report of a panel and the Appellate Body is automatically adopted in WTO dispute settlement.

Second, while GATT provided retaliation without any indication of when it would be ended, the WTO provides that compensation or retaliation does not end the dispute until the violation has been removed. Article 22.1 of the DSU explicitly provides that it is a temporary measure in a situation where the WTO recommendation or ruling is not implemented within a reasonable period of time. This implies that a violating member may not be exempted from WTO obligations simply by providing compensation or accepting retaliation. Rather, it requires the violating member to bring its measure into conformity with the WTO ruling.

Third, the WTO introduces cross-retaliation when retaliation in the same sector(s) is not strong enough to achieve compliance. If the purpose was simply to rebalance the concessions between the disputing members, there would be no need to impose such types of retaliation.²⁶²

Fourth, under Article 22.8 of the DSU, the DSB continues to keep the implementation of adopted recommendations or rulings under surveillance even when compensation has been provided or retaliation has been imposed. This strongly implies that remedies are aimed not at full compensation, but on full compliance.²⁶³

²⁶¹ With the request of the complaining member, a defending member cannot delay the establishment of a panel unless the DSB decides by consensus not to do so. *See* DSU art. 6.1.

²⁶² *See* Ch. 2. Sec. II. 3.2.1.

²⁶³ In addition, the WTO makes an effort to provide a compliance mechanism outside the ambit of the DSU

3. Concluding Remarks

In this Section, I have examined the purpose of WTO remedies from a historical perspective. In this examination, I discovered that the concept of remedies has changed from GATT to the WTO. While the purpose of remedies under GATT was initially to restore the balance of benefits between the parties to a dispute, the purpose of inducing compliance has been added in the WTO.

Moreover, I discovered that the structure of remedies has evolved from GATT to the WTO. First, the binding nature of WTO decisions has been enhanced in the direction of requiring members to bring inconsistent measures into compliance. Second, a number of procedures have changed or been newly introduced in the WTO with the effect of enhancing its compliance-inducing effect.

Overall, historically, the legal transformation toward enforcement created the purpose of inducing compliance in WTO remedies along with the purpose of restoring the balance of reciprocal benefits between the disputing members.

II. The Purpose of WTO Remedies from a Contractual Perspective

In this Section, I will examine the purpose of WTO remedies from a contractual perspective. Figuring out the purpose in the contractual perspective would be meaningful in the sense that compliance and rebalancing advocates analogize their views with two

scheme. Although its reports have no binding effect, the Trade Policy Review Mechanism (TPRM) can put pressure on a member to comply with its obligations. The purpose of the TPRM, by which the trade policies and practices of each member are reported on and reviewed by the Trade Policy Review Body, is to “contribute to improved adherence by all Members to rules, disciplines and commitments [under the WTO agreements] . . . by achieving greater transparency in, and understanding of, the trade policies and practices of Members.” Trade Policy Mechanism, ¶ A(i), Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 3, 1869 U.N.T.S. 480 (1994). For a general explanation on the TPRM, see Julien Chaisse & Debashis Chakraborty, *Implementing WTO Rules through Negotiations and Sanctions: The Role of Trade Policy Review Mechanism and Dispute Settlement System*, 28 U. Pa. J. Int’l Econ. L. 153 (2007).

different rules of contract remedies.

In the following, I will begin with a general explanation of WTO agreements in relation to contracts and examine how WTO remedies are viewed in the context of contract remedies.

1. General Understanding of Contract Remedies

1.1. General Remarks

International treaties have long been analogized to private contracts.²⁶⁴ This may be because treaties establish rights and obligations between parties similar to what are created under contracts. As Janis notes, “treaties are in the first place essentially contracts between states.”²⁶⁵

Parties to a contract make a mutual exchange of promises that would normally be expected to result in the maximization of their individual interests. In this sense, the WTO agreement, as a form of international treaty, could also be considered as a contract where members seek to promote their mutual interests by entering into an agreement. Each WTO member would probably value the things received more highly than those given away by entering into the WTO agreements. Hence, they may maximize their joint gains by complying with WTO agreements. In *Japan – Alcoholic Beverages*, the Appellate Body acknowledged that “the WTO Agreement is a treaty – *the international*

²⁶⁴ See generally Curtis J. Mahoney, *Treaties as Contracts: Textualism, Contract Theory, and the Interpretation of Treaties*, 116 Yale L.J. 824 (2007); Robert E. Scott & Paul B. Stephan, *The Limits of Leviathan: Contract Theory and the Enforcement of International Law* (2006); John Norton Moore, *Treaty Interpretation, the Constitution and the Rule of Law* (2001). For a critical view, Jeffrey L. Dunoff & Joel P. Trachtman, *Economic Analysis of International Law*, 24 Yale J. Int'l L. 1, 30 (1999) (Illustrating theoretical and structural differences between contracts and treaties). See also Evangelos Raftopoulos, *The Inadequacy of the Contractual Analogy in the Law of Treaties* (1990).

²⁶⁵ Mark Janis, *An Introduction to International Law* 9 (2nd ed. 1993).

equivalent of a contract.”²⁶⁶

Common features of WTO agreements and private contracts are that parties negotiate and sign them to bind themselves. Thus, contracts create a legal bond only to the parties and gain their validity from the agreement of the parties. This seems true because the membership of the WTO is achieved by the “contractual consent of states to be bound to the rules of that system.”²⁶⁷ In addition, it becomes more obvious when a dispute occurs because it arises only in respect of the members whose trade relations are disturbed, and not to all members of the system.²⁶⁸

1.2. Contract Remedies: *Property Rules and Liability Rules*

Parties to a contract make a mutual exchange of promises that would result in the maximization of each of their interests. However, if one of the parties decides that those promises are no longer in its interest, it can deviate from such promises. Likewise, a WTO member may decide that it is no longer valuable for it to comply.

In this circumstance, a breaching party (or a violating member in the WTO context) has to provide an adequate remedy in order to be relieved from the contractual obligations. There are two types of remedies under private contracts: property rules and

²⁶⁶ *Japan – Alcoholic Beverages*, *supra* note 252, ¶ 16 (emphasis original). See also *Trans World Airlines Inc. v. Franklin Mint Corp.*, 466 U.S. 243, 253 (1984) (Stating that “a treaty is in the nature of a contract between nations”).

²⁶⁷ Schwartz & Sykes, *supra* note 233, at S180. In addition, consider that the members of GATT were referred as “contracting parties.”

²⁶⁸ See Pauwelyn, *supra* note 228, at 340. See also G. Richard Shell, *Trade Legalism and International Relations Theory: An analysis of the World Trade Organization*, 44 Duke L. J. 829, 863-864 (1995) (Arguing that the dispute settlement system provides states a means to regulate “violations of the contractual ‘obligations’ that arise from trade treaties”). However, the difference is that the disputants and beneficiaries differ in WTO disputes, whereas they are same in private contract disputes. In the WTO, the disputants are usually governments and the beneficiaries are usually private entities or individuals. Thus, although the governments will heed the interests of their industries or individuals to a certain extent, they are likely to settle the dispute for their own interests. See John Linarelli, *The Role of Dispute Settlement in World Trade Law: Some Lessons from the Kodak-Fuji Dispute*, 31 Law & Pol’y Int’l Bus. 263, 331 (2000).

liability rules.²⁶⁹ A property rule results in an issuance of an injunction or a requirement of specific performance, whereas a liability rule results in an award of damages. The remedy of specific performance or injunction is an equitable remedy that is enforced within the court's discretion when an award of damages is inadequate or inappropriate. The remedy of specific performance requires precise fulfillment of contractual obligations or a waiver from those obligations by the breachee – a waiver presumably granted in exchange for payment. By definition, it is to force a promisor to perform its contractual obligations. Thus, it would be the most accurate form of compensation.²⁷⁰ The remedy of injunction requires a “party to do or to refrain from doing a particular thing.”²⁷¹ On the other hand, damages are generally the sum of money that a person is entitled to as compensation for loss or injury.²⁷² In sum, contract rights are protected by requiring a breaching party either to perform its contract under property rules or to pay adequate damages under liability rules.

A standard distinction has been made between these two rules. It is whether a holder has an absolute right to his entitlement. A property rule provides a right to a person to keep an entitlement unless he voluntarily chooses to part with it. It is a holder's exclusive and absolute right to retain or part with his entitlement. Thus, a promisor must get permission from a promisee to deviate from its contract.²⁷³ In this regard, the protection of voluntary exchange is offered only under property rules for stable and productive legal

²⁶⁹ For a general understanding of contract remedies, see Paul G. Mahoney, *Contract Remedies: General*, in *Encyclopedia of Law and Economics* 117 (Boudewijn Bouckaert & Gerrit De Geest eds., 1999); Saul Levmore, *Unifying Remedies: Property Rules, Liability Rules, and Startling Rules*, 106 Yale L. J. 2149 (1997); E. Alan Farnsworth, *Legal Remedies for Breach of Contracts*, 70 Colum. L. Rev. 1145 (1970).

²⁷⁰ See George Williams Keeton, *An Introduction to Equity* 304 (5th ed. 1961).

²⁷¹ Howard Clifford Joyce, 1 *A Treatise on the Law Relating Injunctions* 2-3 (1909).

²⁷² See Frank Gahan, *The Law of Damages* 1 (1936).

²⁷³ See generally Richard A. Epstein, *A Clear View of The Cathedral: The Dominance of Property Rules*, 106 Yale L. J. 2091 (1997); Emily Sherwin, *Introduction: Property Rules as Remedies*, 106 Yale L. J. 2083 (1997); Alan Schwartz, *The Case for Specific Performance*, 89 Yale L. J. 271, 271 (1979).

arrangements.²⁷⁴ In contrast, a liability rule denies the exclusive right of a holder and provides that a promisor can take away the entitlement without getting permission from a promisee.²⁷⁵

Under the *Restatement (Second) of Contracts*, the general remedy for breach is the expectation measure of damages under liability rules. The purpose of awarding expectation damages is to place a promisee “in as good a position as he would have been in had the contract been performed.”²⁷⁶ In other words, the expectation measure of damages makes the promisee indifferent between the award and the performance. Thus, by definition, the former would be the value of the latter. Equitable relief, specific performance or an injunction may be ordered under property rules only when expectation damages are inadequate.²⁷⁷ Expectation damages would be generally considered inadequate when there are difficulties of proving damages.²⁷⁸ Another reason for restricting the use of property rules seems to arise from the practical difficulties of enforcing such rules.²⁷⁹

²⁷⁴ See David Hume, *A Treatise of Human Nature* 484-516 (1978) (Arguing that a property rule is one of the dominant rules of society to the extent that a voluntary transaction provides the stability of possession).

²⁷⁵ In addition, setting an appropriate level of damages is important in order to make a distinction between property rules and liability rules. High damages under liability rules would be equivalent to property rules of protecting victims, whereas low damages would be equivalent to those of protecting injurers. See generally A. Mitchell Polinsky & Steven Shavell, *Enforcement Costs and the Optimal Magnitude and Probability of Fines*, 35 J. L. & Econ. 133 (1992); A. Mitchell Polinsky & Daniel L. Rubinfeld, *The Welfare Implications of Costly Litigation for the Level of Liability*, 17 J. Legal Stud. 151 (1988). The discussion on the contract remedy of property rules and liability rules was mainly done by law and economics scholars in order to define which rule would best serve as an optimal remedy. They examine the remedy rules under the joint value maximization where both parties could be made better off from a contract. See generally Steven Shavell, *Specific Performance Versus Damages for Breach of Contract: An Economic Analysis*, 84 Tex. L. Rev. 831 (2006); Louis Kaplow & Steven Shavell, *Property Rules and Liability Rules: An Economic Analysis*, 109 Harv. L. Rev. 713 (1996); Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of Cathedral*, 85 Harv. L. Rev. 1089 (1972).

²⁷⁶ Restatement (Second) of Contracts § 344(a) (1981).

²⁷⁷ Restatement (Second) of Contracts § 359(1) (1981).

²⁷⁸ Restatement (Second) of Contracts § 360 (1981).

²⁷⁹ A court generally has a difficulty in enforcing specific performance. Judges have to invest greater time and efforts to supervise the quality of performance. See generally E. Allan Farnsworth, *Contracts* 751-756 (3rd ed. 2004); William Bishop, *The Choice of Remedy for Breach of Contract*, 14 J. Legal Stud. 299, 307

A transfer of entitlements under property rules occurs only through a voluntary negotiation by the parties to a contract, employing a subjective standard of value for the transfer, whereas, under liability rules, it occurs only through a reassignment by a third party such as a court, employing an objective standard of value for the transfer.

2. WTO Remedies from a Contract Remedy Perspective

2.1. General Remarks

How are these two different rules of contract remedies applied in the WTO context? Or, more precisely, which rule do WTO remedies follow in case of violations?

Compliance advocates argue that property rules apply in case of violations, whereas rebalancing advocates argue that liability rules apply in case of violations. These two views make the debate on the purpose of remedies serious because the two contract remedy rules have completely different legal consequences. While compliance advocates tend to keep within the agreement, rebalancing advocates tend to deviate from the agreement. Thus, depending on what rule applies, the purpose of WTO remedies will vary drastically.

In this sub-Section, I will examine WTO remedies in the context of the two contract remedy rules. It is worth mentioning, however, that the purpose of this dissertation is to examine which contract remedy rule WTO remedies follow in the case of violations rather than to find a more effective remedy rule over another. Thus, it will not examine which rule would be optimal in the situation of WTO violations.

2.2. WTO Remedies in the Context of Property Rules

(1985); Schwartz, *supra* note 273, at 273 & 292-293.

Recall that property rules guarantee a voluntary transfer by providing a holder's exclusive right on his entitlement. Thus, in order for a promisor to deviate from its contractual obligation, it has to get permission from a promisee. In other words, they have to enter into a negotiation in order for a promisor to be released from performing a contract by paying a certain amount of release costs.

In this vein, compliance advocates argue that the WTO provides a remedy of specific performance that a violating member has an obligation to bring the inconsistent measure into conformity with WTO agreements. And, the only way to avoid the obligation to comply with WTO agreements is through negotiations between the parties to a dispute.²⁸⁰ Does this really happen in WTO dispute settlement?

2.2.1. Dispute Settlement through Negotiations

Generally, negotiations take place, as under property rules, to settle disputes between members in the WTO. Prior to a panel process, members attempt to settle a dispute through a consultation process. During this process, a violating member will try to negotiate deviation from compliance similar to the remedy of property rules in private contracts. Usually, an injured member will sell such deviation for an amount at least equal to the value of compliance and the violating member will buy it for an amount up to that value.²⁸¹ The WTO takes over the dispute only when an injured member requests a panel upon the failure of the consultation process. This usually happens when an injured member is dissatisfied with the offers made by the violating member in the consultation

²⁸⁰ See, e.g., Nzelibe, *supra* note 232, at 246-248.

²⁸¹ Again, note that the payment of a breaching party is determined by a subjective value under property rules, whereas it is determined by an objective value of a third party under liability rules. See Calabresi & Melamed, *supra* note 275, at 1092.

process.²⁸² Thus, although the possibility of high negotiation and release costs exists, WTO members endure these costs in order to prevent a violating member from avoiding its contractual obligations at will.²⁸³

²⁸² WTO members can settle disputes without recourse to the WTO adjudicative system. In other words, they can voluntarily negotiate for their entitlement protection. The WTO itself has no legal standing to claim a violation of its rules. Only members whose benefits are nullified or impaired by the violation are able to claim for legal relief. If the WTO had legal standing to accuse members of violation, an entitlement would rather be protected under an inalienability rule where a court directly enforces the provision of remedies, thereby prohibiting any *ex post* discretion; indeed, a voluntary transfer of an entitlement by the parties to a dispute is not permitted. If this rule were to be applied in the WTO, it would make the debate between property and liability rules unnecessary. For a view of an inalienability rule of entitlement protection in the WTO context, see Simon A.B. Schropp, *Revisiting the "Compliance-vs.-Rebalancing" Debate in WTO Scholarship: Toward a Unified Research Agenda* (Graduate Inst. of Int'l Stud. (HEI), Working Paper No. 29, 2007), available at http://hei.unige.ch/sections/ec/pdfs/Working_papers/HEIWP29-2007.pdf.

²⁸³ A crucial problem of property rules is that negotiation or release costs may be too high to facilitate a voluntary transfer. This may lead to a failure of a negotiation because it would require much time and resources. The asymmetry of information access between parties may also lead to a breakdown. Thus, a post-contractual negotiation involves high costs that may lead to losses in joint value and wasteful performance may occur. See Calabresi & Melamed, *supra* note 275, at 1106; Schwartz, *supra* note 273, at 274; Mahoney, *supra* note 269, at 119-120. See also Pierpaolo Battigalli & Giovanni Maggi, *Rigidity, Discretion, and the Costs of Writing Contracts*, 92 Am. Econ. Rev. 798 (2002). Then, how do negotiation costs operate in the WTO? Generally, the negotiation cost in settling a dispute seems to be high. For instance, in case of providing compensation, the violating member has to negotiate with all the members that have been affected by the inconsistent measure under MFN treatment to be free from compliance. Alan O. Sykes, *Comment on Chapter 2*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 66, 71 (Chad P. Bown & Joost Pauwelyn eds., 2010); Sykes 2000, *supra* note 233, at 355. See also Andrew Green & Michael Trebilcock, *Enforcing WTO Obligations: What can we learn from Export Subsidies?*, 10 J. Int'l Econ. L. 653, 671 (2007) (Pointing out the problem of compensation under MFN treatment in export subsidies). For an empirical analysis on transaction costs in WTO disputes, see Andrew T. Guzman & Beth A. Simmons, *Power Plays and Capacity Constraints: The Selection of Defendants in World Trade Organization Disputes*, 34 J. Legal Stud. 557 (2005). In addition, a "hold-out" problem may occur, since affected members may attempt to extract more from the negotiation. Accordingly, a negotiation may break down and the opportunity for efficient adjustment of the bargain may be jeopardized. See Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. Cal. L. Rev. 629 (1988) (Arguing that parties will be cautious to avoid a holdout situation). In this regard, some tend to argue that a liability rule is more efficient in cases where transaction costs are high because damages under liability rules seem to be more desirable in that they may prevent excessive and costly performance. Thus, a property rule is efficient only in cases where transaction costs are low. See Calabresi & Melamed, *supra* note 275, at 1106-1110. See also Jay Weiser, *The Real Estate Covenant as Commons: Incomplete Contract Remedies over Time*, 13 S. Cal. Interdisc. L.J. 269 (2004); Louis Kaplow & Steven Shavell, *Do Liability Rules Facilitate Bargaining? A Reply to Ayres and Tally*, 105 Yale L.J. 221 (1995); Shavell, *supra* note 275, at 836-844. In this regard, Posner argues that restricting specific performance reduces post-breach negotiation costs. See Richard A. Posner, *Economic Analysis of Law* 88-89 (2d ed. 1977). Nonetheless, there are three counter-arguments that question this argument. First, Ulen argues that transaction costs may not be high in a post-breach situation. The reason is that the parties would have already done a substantial amount of negotiations at the stage of contract formation. So to speak, they have already indentified each other, bargained possible contingencies, and, perhaps, stipulated types of remedies for a breach. Thus, the negotiation that has to be carried out after the breach would only be concerned with what sort of remedies would be optimal for the disputing parties. In this regard, the cost of negotiation to settle a dispute would likely be low in a post-breach situation. Thomas S. Ulen, *The Efficiency of Specific Performance: Toward a*

Then, how are property rules applied at the stage of remedies? The remedy of property rules appears to clearly be evident in situations involving the provision of compensation. At first glance, the provision of compensation in the WTO seems to resemble the award of damages under liability rules. However, this perception is misleading. If the violating member fails to comply within a reasonable period of time, it voluntarily enters into a negotiation with the complaining member in order to determine mutually acceptable compensation.²⁸⁴ It is not a third party, whether a panel or the Appellate Body, that determines the amount of compensation. It is the parties to a dispute that determine its value. In this regard, compensation seems to be the temporary release cost incurred by the violating member for not bringing the inconsistent measure into conformity with the WTO agreement immediately. As mentioned in the previous Chapter, there were instances where disputing members entered into negotiations and agreed on mutually acceptable compensation as a temporary release by reducing tariffs, removing quantitative restrictions and increasing import quotas.²⁸⁵

When it comes to implementing retaliation, it seems quite difficult to apply contract remedy rules because it is the adversely affected party (*promisee*) who takes action that

Unified Theory of Contract Remedies, 83 Mich. L. Rev. 341, 369, 379-380 (1984) (He further notes that this would be a “strong *prima facie* reason” for requiring specific performance rather than awarding damages). See also Schwartz, *supra* note 273, at 287. Second, as Maggi and Staiger argue, the cost of transfer under liability rules would be also high in international trade agreements because it induces more transfer in equilibrium. See Giovanni Maggi & Robert W. Staiger, *Breach, Remedies and Dispute Settlement in Trade Agreements* 5 & 18-19 (Cowles Found. for Res. in Econ. at Yale U., Discussion Paper No. 1735, 2009), available at <http://ssrn.com/abstract=1494451>. Third, no matter how high the negotiation cost is, parties will go to the court and follow its decisions. This is because the purpose of parties for bringing disputes to the court is to confirm the legitimacy of the measures concerned with obtaining a definitive and authoritative resolution. See Ian Brownlie, *Why Do States Take Disputes to International Court?*, in 2 *Liber Amicorum Judge Shigeru Oda* 829 (Nisuke Ando, Edward McWhinney & Rudiger Wolfrum eds., 2002). In this sense, members will rely on the decision of the WTO adjudicative system, irrespective of the costs of negotiations.

²⁸⁴ Article 22.1 of the DSU provides that “[c]ompensation is voluntary.” This is different from compensation under private contracts where it is mandatory in case of a breach.

²⁸⁵ See Ch. 2. Sec. II. 2.

provides it with relief in the WTO, while it is the violating party (*promisor*) who takes action by providing relief under private contracts. At first glance, however, irrespective of the “transaction” and concerning only the “remedy” itself, retaliation seems to resemble action under liability rules in the sense that it does not require the consent of both parties for its implementation and that a third party, the arbitrators in the case of the WTO, determines the level of retaliation. However, when it comes to the stage of actual implementation, the violating member attempts to negotiate with the complaining member to be released from suffering retaliation, which means the situation more closely resembles that of property rules. For instance, in *EC – Bananas*, the EC entered into negotiations with the US after enduring long-term retaliation and agreed not to reintroduce discriminatory measures among banana distributors based on the ownership or control of the distributors or the source of the bananas.²⁸⁶ Moreover, in *EC – Hormones*, the EC and the US entered into negotiations to settle a long standing retaliation, whereby the EC agreed to provide additional duty-free access for US beef to the European market. In return, the US agreed to eliminate all beef-related retaliation against the EC during the fourth year of the agreement.²⁸⁷

In light of the above, it can be said that retaliation has shifted from being a liability rule-type remedy to becoming a property rule-type remedy by providing voluntary bargaining for entitlement protection. This is what is called a “pliability rule” remedy, building flexibility into the remedy rule by switching from property rules to liability rules, or *vice versa*, when a certain condition changes. A pliability rule is dynamic in the sense

²⁸⁶ See Len Bracken, *U.S., EC Agree to Settle Dispute over Latin American Bananas*, *USTR Says*, 27 Int’l Trade Rep. (BNA) 856 (Jun. 10, 2010).

²⁸⁷ See Gary G. Yerkey, *U.S., EU Announce Provisional Deal in Long-Running Dispute over Beef Trade*, 26 Int’l Trade Rep. (BNA) 611 (May 7, 2009).

that it combines the features of property and liability rules over the course of time, whereas property rules and liability rules are static. Thus, a court may demonstrate flexibility in applying the rule when economic efficiency or fairness so requires.²⁸⁸

In sum, WTO remedies are ultimately applied in a way that is similar to the remedy found in property rules when it comes to providing compensation and implementing retaliation. A violating member generally enters into a negotiation with a complaining member and pays a temporary release cost if it is unable to comply immediately. This clearly indicates that the WTO guarantees voluntary bargaining for entitlement protection under property rules.

2.2.2. Targeting Ongoing Violations

In comparing WTO violations with contractual breaches, it is important to note that there is a significant difference in the nature of the breach of obligations. Under a breach of a private contract, the assumption is that a promisor did not perform its part of the bargain. In that instance, a promisor would be required to pay damages equal to the benefit that a promisee would have received if the promise was performed. Thus, the promisee would be made whole by the payment for damages. Of course, there are similar instances in the WTO where reparations equal the harm of the injured member. For instance, when a state grants a one-time subsidy to its domestic enterprise, the affected members are injured only at the time when the subsidy is granted. And since the level of nullification from such subsidies could be easily determined, a payment would presumably make whole the injured member. In this situation, the non-recurring nature of

²⁸⁸ See Abraham Bell & Gideon Parchomovsky, *Liability Rules*, 101 Mich. L. Rev. 1 (2002). Specifically, WTO retaliation could be compared to the remedy of “liability rules” which trigger a change in protection from liability to property rules. *Id.* at 53-54.

subsidies seems to resemble the nature of contractual breaches because an award of damages could fully repair the breach by bringing the injured member into the situation that existed before the subsidy was granted.²⁸⁹

However, the above illustration is not a common occurrence in the WTO. Unlike one-time contract violations, most WTO violations continue to have damaging effects on trade for as long as they are in force. Generally, the WTO dispute settlement system is built to deal with these types of violations. First, a panel or the Appellate Body recommends that a violating member bring its inconsistent measure into conformity only when that measure is still in force. Second, as mentioned above, the DSU is designed to stop this type of violation by setting up a reasonable period of time for compliance and introducing surveillance procedures until compliance is achieved. The surveillance procedure is designed specifically to monitor compliance, which is similar to the practice of courts when they seek to enforce and monitor specific performance that has been ordered. These factors strongly indicate that the WTO dispute settlement system resembles the remedy of specific performance available under property rules by requiring a violating member to precisely fulfill its WTO obligations.

2.3. WTO Remedies in the Context of Liability Rules

So far, we have concluded that WTO remedies resemble property rule remedies by guaranteeing voluntary bargaining for entitlement protection. As such, it can be said that the WTO does not appear to provide liability rule remedies.

Rebalancing advocates, however, attempt to argue that the remedy procedure under

²⁸⁹ However, it is important to recall that WTO remedies are not retroactive. In practice, the level of retaliation is determined as of the expiration of the reasonable period of time and, thus, retaliation is applied prospectively.

the DSU resembles the award of damages for breach of contract under liability rules. They go one step further by arguing that the purpose of WTO remedies is to not only restore the balance of benefits, but also pay damages in the form of compensation or retaliation. Thus, in their view, a violating member has the option to remain in violation of its obligations and pay damages.²⁹⁰ The basis for their argument is the DSU provision that requires the authorized level of retaliation to be equivalent to the injury suffered, which prevents the price of breach from becoming too high. In other words, by providing a possibility for members to buy their way out of WTO obligations, this provision promotes efficient breach.²⁹¹

However, in my view, efficient breach cannot be justified in the WTO. There are at least two reasons which support this position. First, there is the problem of estimating expectation damages. WTO remedies do not provide compensation in a manner that is consistent with the liability rules of private contracts. Second, the introduction of the standard of equivalence was never intended to facilitate efficient breach. Rather, it was intended to prevent the abusive use of retaliation.

In the following, I will begin with a general explanation of efficient breach and then examine the problems of efficient breach in the WTO context and the intended goal of the

²⁹⁰ See Sykes 2010, *supra* note 233; Schwartz & Sykes, *supra* note 233, at S188. See also Trachtman, *supra* note 220; Kornel Mahlstein & Simon A.B. Schropp, *The Optimal Design of Trade Policy Flexibility in the WTO* 14 (Graduate Inst. of Int'l Stud. (HEI), Working Paper No. 27, 2007) (Arguing that WTO retaliation establishes "violation-cum-retaliation as the *de facto* default rule of non-performance"), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1066663; Heinz Hauser & Alexander Roitinger, *Renegotiation in Transatlantic Trade Disputes*, in *Transatlantic Economic Disputes* 487 (Ernst-Ulrich Petersmann & Mike A. Pollack eds., 2003).

²⁹¹ See generally Schwartz & Sykes, *supra* note 233, at S191 (Arguing that, if WTO remedies were to have a compliance-inducing effect, they should have imposed something more than "equivalent retaliation"). Trachtman also argues that, if the WTO had to order specific performance of property rules, it should have had both "injunctive force" and "supra-equivalent damages." Trachtman, *supra* note 220, at 147-148. See also Enzo Cannizzaro, *The Role of Proportionality in the Law of International Countermeasures*, 12 Eur. J. Int'l L. 889, 891-892 (2001) (Arguing that a coercive response should be required in order to induce compliance).

standard of equivalence. In addition, I will discuss the difference between the purposes of rebalancing benefits and providing compensation.

2.3.1. Efficient Breach in the WTO Context

2.3.1.1. General Understanding of Efficient Breach

The discipline of law and economics teaches that the law should be aimed at maximizing the welfare of society by allocating resources to the parties who value them the most.²⁹² In this sense, it should be designed to facilitate a breach of an obligation when it leads to the optimal allocation of resources among parties because this would avoid unnecessary performance. In other words, the law should not prevent a breach of contract when the breach brings an optimal outcome and the breaching party pays the full economic cost for its misbehavior. Accordingly, the notion of efficient breach flows from the idea that the law should promote efficiency. The key idea of efficient breach is that it is permissible to breach a contract if the breach makes one party better off, without making the other worse off than he or she would have been had performance occurred. Thus, the joint gain of both parties is paramount to the concept of efficient breach.

Law and economics scholars tend to base their argument on price theory.²⁹³ From this perspective, the key to performance is the price of a breach. The argument is that when the price of a breach is considerably high, performance will result. On the other hand,

²⁹² See generally Robert Cooter & Thomas Ulen, *Law and Economics* 262-269 (5th ed. 2007). See also Richard A. Posner, *Economic Analysis of Law* 118-126 (7th ed. 2007) (Asserting that the choice between performance and compensation holds “an important economic insight”).

²⁹³ For a general understanding on this issue, see, e.g., Robert J. Rhee, *A Price Theory of Legal Bargaining: An Inquiry into the Selection of Settlement and Litigation under Certainty*, 56 *Emory L. J.* 619 (2006); Jack Hirshleifer, Amihai Glazer & David Hirshleifer, *Price Theory and Applications: Decisions, Markets, and Information* (2005); Clark A. Remington, *Intentional Interference with Contract and the Doctrine of Efficient Breach: Fine Tuning the Notion of the Contract Breacher as Wrongdoer*, 47 *Buff. L. Rev.* 645 (1999).

when the price of performance exceeds the price of a breach, a promisor is better off to breach rather than to perform a contract because the amount that a promisor has to pay for a breach is lower than the price of performance.²⁹⁴

Then, how is it that the promisee is no worse off from such breaches? The answer seems quite simple. A promisee would be no worse off if a promisor could pay damages so as to place the promisee in as good a position as he would have been in had the contract been performed. As described earlier, the promisee's full expectation of gain is recovered by expectation damages. Perfect expectation damages would make the promisee indifferent between performance and breach. Thus, expectation damages deter inefficient breaches because a promisor will not wish to breach and pay damages unless it gains more from the breach than the promisee loses.²⁹⁵ Overall, this theory aims to deter inefficient breaches and to facilitate efficient breaches.²⁹⁶

²⁹⁴ Then, when or why would the price of performance be high? Generally, a contract is always incomplete. It is hardly possible for the parties to anticipate every contingency that may materialize and to specify all the contingencies in the contract. From the very beginning, parties usually lack the foresight to deal with all possible situations at the stage of contract formation. In this regard, there may be a situation where a promisor faces an unexpectedly higher price of performance after the contract is signed. *See generally* Scott Baker & Kimberly D. Krawiec, *Incomplete Contracts in a Complete Contract World*, 33 Fla. St. U. L. Rev. 725 (2006); Robert E. Scott & George G. Triantis, *Incomplete Contracts and the Theory of Contract Design*, 56 Case W. Res. L. Rev. 187 (2005); Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 Yale L.J. 729 (1992); Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. Legal Stud. 271 (1992). It is not all that different in the context of the WTO agreement. It is also incomplete in the sense that it is negotiated among members of having complex relationships and in the face of enormous uncertainty about the future. *See* B. Peter Rosendorff, *Stability and Rigidity: Politics and Design of the WTO's Dispute Settlement Procedures*, 99 Am. Pol. Sci. Rev. 389 (2005); B. Peter Rosendorff & Helen V. Milner, *The Optimal Design of International Trade Institutions: Uncertainty and Escape*, 55 Int'l Org. 829 (2001). For an economic analysis of the incompleteness of WTO agreements, see Henrik Horn, Giovanni Maggi & Robert W. Staiger, *Trade Agreements as Endogenously Incomplete Contracts* (Nat'l Bureau of Econ. Research, Working Paper No. 12745, 2006), available at <http://www.nber.org/papers/w12745>. In this regard, the price of compliance to a violating member may exceed the price of a breach because the price of compliance is recognized by the members after the agreement is signed. Considering the price of breach equal to the amount of damages, it would be undesirable for a violating member to comply with the WTO agreement because it has to pay more for compliance than breaching. Thus, the incompleteness of WTO agreements may result in a situation where compliance may impede economic growth and social welfare, which makes performance undesirable. *See* Simon A.B. Schropp, *Trade Policy Flexibility and Enforcement in the WTO: Reform Agenda Towards an Efficient "Breach" Contract* (2008).

²⁹⁵ A promisee's loss from breach would be equal to expectation damages, which would be the amount that

2.3.1.2. Problems of Estimating Expectation Damages

Do WTO remedies provide expectation damages in an amount appropriate to facilitate efficient breach? In practice, this seems unlikely to happen. There are at least two reasons for this conclusion. First, the arbitrators' determination on the level of retaliation is a mere approximation. Estimating the value of WTO entitlements is necessarily approximate.²⁹⁷ The arbitrators in *US – Gambling (Article 22.6 – US)* expressed their concern by stating:

We, therefore, have no choice but to adopt our own approach. In so doing, we feel we are on shaky grounds solidly laid by the parties. The data is surrounded by a degree of uncertainty. For most variables, the data consists of proxies for what needs to be measured, and observations are too few to allow for a proper econometric analysis. Certain data that we have requested and that, to some extent, could have remedied this situation has not been provided. On methodological questions, parties, in a number of respects, have retained their extreme positions and have failed to propose alternative solutions that would have taken into account the exchange of arguments.

a promisor has to pay. For a general understanding, see John H. Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. Legal Stud. 277, 283-289 (1972); Robert L. Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 Rutgers L. Rev. 273, 284-286 (1970). In these circumstances, rebalancing advocates argue that it would be in the joint interest for the members to deviate from their obligations, which were not anticipated in the agreement, by paying expectation damages. Schwartz & Sykes, *supra* note 233, at S191-S192. See also T. N. Srinivasan, *The Dispute Settlement Mechanism of the WTO: A Brief History and an Evaluation from Economic, Contractarian and Legal Perspectives*, 30 World Econ. 1033, 1046 (2007).

²⁹⁶ For more on efficient breach, see Craswell, *supra* note 283; Lewis A. Kornhauser, *An Introduction to the Economic Analysis of Contract Remedies*, 57 U. Colo. L. Rev. 683 (1986); Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 Colum. L. Rev. 554 (1977). However, for criticisms on efficient breach, see Joseph M. Perillo, *Misreading Oliver Wendell Holmes on Efficient Breach and Tortious Interference*, 68 Fordham L. Rev. 1085 (2000); Craig S. Warkol, Note, *Resolving the Paradox Between Legal Theory and Legal Fact: The Judicial Rejection of the Theory of Efficient Breach*, 20 Cardozo L. Rev. 321, 343 (1998); Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. Legal Stud. 1 (1989); Patricia H. Marschall, *Willfulness: A Crucial Factor in Choosing Remedies for Breach of Contract*, 24 Ariz. L. Rev. 733 (1982); Daniel A. Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 Va. L. Rev. 1143 (1980).

²⁹⁷ See Joost Pauwelyn, *The Calculation and Design of Trade Retaliation in Context: What is the Goal of Suspending WTO Obligations?*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 34, 63 (Chad P. Bown & Joost Pauwelyn eds., 2010) (Arguing that “the pricing of WTO entitlements, is at best approximation, at worst an educated guess; it clearly is an art, not a science”).

Hence, we are left with precious little information and guidance. Nevertheless, we will attempt to stay as closely to the approaches proposed by parties as possible and to make a maximum use of the limited information base we were given, in particular to carry out some sensitivity analysis in support of our main approach.²⁹⁸

To the extent that arbitrators' assessments of the level of nullification or impairment are only approximate, they may result in a level of retaliation that does not represent the true cost of the violation of the WTO agreement.²⁹⁹ If the level of retaliation is systematically undervalued, this could lead to an increase in breaches that cannot be economically justified.³⁰⁰ Indeed, in his article, Schropp argues that WTO arbitrators have generally assessed the level of nullification by focusing on the actual losses suffered by the complaining members, instead of taking into account the overall economic gains and losses resulting from non-implementation. By doing so, the arbitrators have constructed a counterfactual situation that opts for reliance damages that re-establish the *status quo ante* the breach, instead of constructing one that opts for expectation damages.

²⁹⁸ US – Gambling (Article 22.6 – US), *supra* note 92, ¶¶ 3.173-3.174.

²⁹⁹ See Thomas Sebastian, *World Trade Organization Remedies and the Assessment of Proportionality: Equivalence and Appropriateness*, 48 Harv. Int'l L. J. 337, 379 (2007); Fritz Bruess, *WTO Dispute Settlement: An Economic Analysis of Four EU-U.S. Mini Trade Wars – A Survey*, 4 J. Industry, Competition & Trade 275, 300-301 (2004); Anderson, *supra* note 209, at 129-130. See also John Gotanda, *Recovering Lost Profits in International Disputes*, 36 Geo. J. Int'l L. 61 (2005) (Explaining on the uncertainty of damage assessment in public international law). Dunoff and Trachtman argue that liability rules have certain drawbacks in the international realm because determining damages requires the "collective expense" of the whole community and would be only an "approximation of the value of the breach to the promisee." Dunoff & Trachtman, *supra* note 264, at 32.

³⁰⁰ See Jorge A. Huerta-Goldman, *Is Retaliation Useful? Observations and Analysis of Mexico's Experience*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 281, 290 (Chad P. Bown & Joost Pauwelyn eds., 2010). Schwartz illustrates a number of reasons why damages are actually under compensatory. He argues that damages are difficult to monetize, especially those costs that are unrecoverable such as frustration and anger. Moreover, assessing expectation damages seems to be inaccurate because prediction makes it difficult to put a promisee in a position where he would have been had its promisor performed. Generally, damages would be estimated only by the promisee's losses from non-performance. Thus, the possibility of under compensation would make the promisee always worse off which would lead to losses in the joint value of both parties. See Schwartz, *supra* note 273, at 276. See also Melvin A. Eisenberg, *Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law*, 93 Cal. L. Rev. 975, 989-996 (2005); Jeffrey Staden, *The Fallacy of Full Compensation*, 73 Wash. U. L.Q. 145, 147 (1995).

Schropp concludes that this inappropriate determination of the level of nullification falls systematically short of fully compensating the complaining members.³⁰¹

Second, there are systematic difficulties for providing expectation damages under the WTO dispute settlement system. Primarily, the level of retaliation is set from the expiration of a reasonable period of time, instead of the time at which the violation was committed. Since it lacks a retroactive effect, retaliation is an insufficient means to achieve any form of *restitutio in integrum* and leaves past injuries uncompensated. Instead of redressing past harms, it mainly seeks to prevent future harm to an injured member. Thus, in a strict sense, the prospective nature of retaliation makes it unlikely that expectation damages will be realized. Additionally, because the retaliating member bears its own economic cost for implementing retaliation, it hardly seems to provide redress in the form of full expectation damages.

Overall, WTO remedies do not provide expectation damages that could be used as a basis to facilitate efficient breach. It is very difficult, if not impossible, to determine the exact level of expectation damages in WTO dispute settlement. The uncertainty of damage assessment would invite a member, depending on the level of damages anticipated, to engage in too much or too little breach. This systematic flaw will end up impeding members' trade liberalization commitments as they will be unsure of what they are obtaining in return for their concessions.³⁰²

³⁰¹ See Simmon Schropp, *The Equivalence Standard under Article 22.4 of the DSU: A 'Tariffic' Misunderstanding?*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 446, 480 & 493 (Chad P. Bown & Joost Pauwelyn eds., 2010). Interestingly, however, Collins suggests that monetary damages under the reliance measure would lead to joint welfare enhancement. He argues that an expectation measure of damages is inappropriate because the level of injury resulting from an illegal trade measure is excessively indeterminate, whereas the reliance interest can be assessed with a reasonable degree of certainty. See David Collins, *Efficient Breach, Reliance and Contract Remedies at the WTO*, 43 J. World Trade 225 (2009).

³⁰² The serious problem of rebalancing advocates is that they run the risk of confusing *what is* and *what*

2.3.1.3. Intended Goal of the Standard of Equivalence

The primary argument of rebalancing advocates is that the standard of equivalence is designed to facilitate efficient breach. Article 22.4 of the DSU clarifies that redress is limited to that which is equivalent to the injury suffered. It restricts the value of trade eliminated by retaliation to the value of trade nullified by the violation. Thus, in their view, the standard of equivalence seeks to ensure that the price of breach is not too high so that a member may have more opportunities to make efficient breaches. For this reason, they conclude that retaliation seems to resemble damages under liability rules, i.e., a form of compensation.³⁰³

However, those advocating this view seem to misunderstand the intended goal of the standard of equivalence. In public international law, without any adjustment, a violating state gains a benefit from an injured state for its wrongful act. In this situation, in order to restore a balanced relationship between the two parties, the injured state should receive a corresponding payment from the violating state either through compensation or countermeasures.

Yet, the nature of countermeasures, in principle, is a violation of public international law, unless they are taken in response to a wrongful act. In other words, countermeasures are justified as long as they are targeted to cause cessation of such wrongful acts. In the same vein, the nature of WTO retaliation is also a violation of the WTO agreement,

should be the purpose of WTO remedies. Here, in this paper, I am to discover what the actual purpose of WTO remedies is. The opt-out possibility of efficient breach is an ideal, but not reality.

³⁰³ Although Posner and Sykes concede that requiring the equivalent level of retaliation to the harm done by the violation is a “crude analogue” to a mechanism of estimating expectation damages, placing such an “upper bound” on the level of retaliation enunciates that “the price for breach should not be prohibitive and thus that breach may be efficient.” See Eric A. Posner & Alan O. Sykes, *Efficient Breach of International Law: Optimal Remedies, “Legalized Compliance,” and Related Issues* 32-34 (U. Chi. John M. Olin Law & Economics Working Paper Series, Working Paper No. 546, 2011), available at <http://ssrn.com/abstract=1780463>. See also Schwartz & Sykes, *supra* note 233, at S188-S189.

unless it is taken in response to a violating member's inconsistent measure. Thus, it could be said that a noteworthy feature of both countermeasures and retaliation is their “‘justified’ illegality.”³⁰⁴

Countermeasures and retaliation are self-redressing tools designed to achieve compliance. While their unilateral character makes implementing them easy, it also means that they are prone to abuse. In public international law, the principle of proportionality acts to prevent such abuses, which is reflected in Article 51 of the ILC Draft. It reads that “[c]ounter-measures must be commensurate with the injury suffered, taking into account the gravity of the internationally wrongful act and the rights in question.” Like public international law, the principle of proportionality is also reflected in the WTO. The term “equivalence” is intended to provide proportionality between the parties to a dispute by limiting the intensity of retaliation as a response to the level of violation concerned.³⁰⁵

In this regard, the introduction of the standard of equivalence is to limit the potential abuse of power by a retaliating member and to prevent overreaching decisions by the WTO adjudicative system. It sets a ceiling which maintains multilateral control with respect to the level of retaliation.

Overall, the standard of equivalence is not intended to make the price of breach

³⁰⁴ Sherzod Shadikhodjaev, *Retaliation in the WTO Dispute Settlement System* 26 (2009).

³⁰⁵ The level of countermeasures or retaliation is limited by introducing some principles such as equivalence, reciprocity and appropriateness that are all encompassed in the principle of proportionality. See Facundo Perez-Aznar, *Countermeasures in the WTO Dispute Settlement System: An Analysis of Their Characteristics and Procedure in the Light of General International Law* 57 (2006). For a general explanation on the principle of proportionality, see David J. Bederman, *The Spirit of International Law* 119-121 (2002); Yutaka Arai-Takahashi, *The Margin of Appreciation Doctrine and the Principle of Proportionality in the Jurisprudence of the ECHR* (2001); D.W. Greig, *Reciprocity, Proportionality, and the Law of Treaties*, 34 Va. J. Int'l L. 295 (1994); Elisabeth Zoller, *Peacetime Unilateral Remedies: An Analysis of Countermeasures* 14-27 (1984). In the WTO, the principle of proportionality is expressed as the standard of “equivalence” under the DSU and “appropriateness” under the SCM Agreement. See generally Andrew D. Mitchell, *Proportionality and Remedies in WTO Disputes*, 17 Eur. J. Int'l L. 985 (2006); Axel Desmedt, *Proportionality in WTO Law*, 4 J. Int'l Econ. L. 441 (2001).

relatively lower than the price of performance in order to facilitate efficient breach.³⁰⁶ Rather, it aims to establish an objective standard for determining the level of retaliation in order to prevent it from being excessive. As Breuss correctly points out, “the concept of equivalence draws more on notions of fairness than on economic accuracy.”³⁰⁷ The intended goal of the standard of equivalence is, therefore, not to undermine the purpose of compliance and to justify continued non-compliance by providing proportionate damages. Instead, it is to ensure the fairness and legitimacy of retaliation in the WTO dispute settlement system.

2.3.1.4. Escape Clause and Schedule Modification

Rebalancing advocates view Articles XIX and XXVIII of GATT as examples of efficient breach.³⁰⁸ Article XIX provides that, when increased competition from imports causes or threatens serious injury to domestic industry, the member may suspend its obligations or withdraw or modify its tariff concessions without securing permission from the exporting member. It requires compensation to be provided to the exporting member. However, if agreement on compensation is not reached, the affected members may also suspend substantially equivalent concessions.³⁰⁹ Under Article XXVIII, a member may also withdraw its tariff concessions for any reason at any time. Like Article

³⁰⁶ Of course, from an economic perspective, it makes the parties to a dispute better off by preventing an excessive level of retaliation because, if a violating member fails to comply under such a level, both members would always be worse off. See Kyle Bagwell and Robert W. Staiger, *GATT-Think* (Nat'l Bureau of Econ. Research, Working Paper No. 8005, 2000) (Characterizing this possibility as “off-equilibrium path retaliation”), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=250360.

³⁰⁷ Fritz Breuss, *Comment on Chapter 20, in The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 503, 506 (Chad P. Bown & Joost Pauwelyn eds., 2010).

³⁰⁸ See Schwartz & Sykes, *supra* note 233, at S185-188; Alan O. Sykes, *Protectionism as a “Safeguard”: A Positive Analysis of the GATT “Escape Clause” with Normative Speculations*, 58 U. Chi. L. Rev. 255, 274-278 (1991); Srinivasan, *supra* note 295, at 1047.

³⁰⁹ See GATT art. XIX:3(a).

XIX, it does not have to secure permission prior to the withdrawal, but may offer compensatory concessions to the affected members.³¹⁰ If the members cannot negotiate for satisfactory compensation, those affected members may also withdraw substantially equivalent concessions.³¹¹ Thus, from the perspective of rebalancing advocates, both Articles seem to create liability rules that are likely to facilitate efficient breach.

However, the arguments of rebalancing advocates are untenable for several reasons. First, there are instances of both property rules and liability rules in these Articles textually. With regard to Article XIX, in order to apply a safeguard measure, the members concerned have to agree on compensation to maintain a substantially equivalent level of concessions, which resembles a negotiation for a release under property rules.³¹² Moreover, it authorizes a safeguard only as a temporary measure, which implies that a member cannot permanently escape from its commitments. The safeguarding member has to comply with its obligations when such injuries due to increased imports are remedied.³¹³ With regard to Article XXVIII, it also provides renegotiations to maintain reciprocal and mutually advantageous concessions.³¹⁴

Second, it is questionable whether these Articles provide a possibility of efficient breach because, as discussed above,³¹⁵ the suspension of concessions hardly provides compensation that leads to an expectation measure of damages.³¹⁶ Third, and most

³¹⁰ See GATT art. XXVIII:2.

³¹¹ See GATT art. XXVIII:3.

³¹² See Agreement on Safeguards, art. 8.1, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Legal Instruments – Results of the Uruguay Round, 33 I.L.M. 1125 (1994) [hereinafter Safeguards Agreement].

³¹³ See Safeguards Agreement art. 7.

³¹⁴ See GATT art. XXVIII:2. See also GATT art. XXVIII bis.

³¹⁵ See Ch. 3, Sec. II. 2.3.1.2.

³¹⁶ Under his empirical observation, Pelc supports the view that the current WTO norms may “generate considerable pressure against such efficient breach mechanisms.” See Krzysztof J. Pelc, *Seeking Escape: The Use of Escape Clauses in International Trade Agreements*, 53 Int’l Stud. Q. 349, 367 (2009).

importantly, there is a difference between the suspension provided for under these two Articles and that provided for under the DSU. Articles XIX and XXVIII refer to equivalence between members' concessions, whereas Article 22 of the DSU refers to equivalence between the level of retaliation and the level of trade nullified or impaired. In this regard, the suspension under the DSU is fundamentally different from the suspension under Articles XIX and XXVIII, which purely concentrates on the balance between members. As Pauwelyn correctly points out, retaliation is, not "the 'price' to be paid for defection, but the 'sanction' for breach, pursuant to the 'property rule' in the DSU."³¹⁷

2.3.2. Difference between Rebalancing and Compensation

So far, we have found that an efficient breach would be difficult to visualize in the WTO because full compensation could never be achieved by the provision of WTO remedies. Thus, due to the fact that the WTO dispute settlement system is unable to make an injured member whole with its remedies, some may suspect that remedies will never restore balance between disputing members.

However, this is not true. Restoring balance and providing compensation operate on separate planes in that they can be achieved at different levels. While equal balance can be achieved through restoring the *status quo ante* by raising the tariffs to the previous level, the full level of compensation can only be achieved by leaving an injured member in a position where it would have been had the agreement been performed.³¹⁸ Thus, there may be a situation where the balance is restored between disputing parties without the

³¹⁷ See Pauwelyn, *supra* note 297, at 61-62. Jackson argues that these provisions are exceptional which is to provide some sort of "breathing space" for violating members to manage the situation that is politically thorny in their domestic legal context. See Jackson 2004, *supra* note 232, at 122.

³¹⁸ See generally Robert Z. Lawrence, Crimes & Punishments? Retaliation under the WTO (2003).

injured party being fully compensated.

Generally, it is thought that retaliation would put the complaining member in the position it was in before the tariff concessions were negotiated, since it is returning back to a level above which it had been previously bound. Yet, in a sense, it can be said that the complaining member is restored at a lower level because retaliation de-liberalizes and decreases the trade flows. However, although retaliation sets the balance at the lower level, it has, at least, avoided an even worse situation where the nullified benefits are left entirely unrecovered. Of course, while neither side would benefit from this result, it would allow them to return to the *status quo ante*. In this sense, both disputing members are no worse off than they were had they not signed the agreement.³¹⁹

Overall, restoring balance and providing compensation are different remedies. They can be achieved at different levels. Thus, the fact that retaliation does not provide full compensation does not necessarily imply that balance between parties to a dispute will not be restored.

3. Concluding Remarks

In this Section, I have examined the purpose of WTO remedies from a contractual perspective. I found that WTO remedies resemble the property rules of contract remedies. In both the provision of compensation and implementation of retaliation, a violating

³¹⁹ See *id.* at 36-39 & 44. See also Giorgio Sacerdoti, *The Nature of WTO Arbitrations on Retaliation*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 23, 24 (Chad P. Bown & Joost Pauwelyn eds., 2010); Wilhelm Kohler, *The WTO Dispute Settlement Mechanism: Battlefield or Cooperation? A Commentary on Fritz Breuss*, 4 J. Industry, Competition & Trade 317, 331-332 (2004) (Arguing that the rebalancing of political economy benefits participating governments). Of course, restoring balances of benefits may partially compensate an injured member, but it can never make the member whole. See Christopher F. Corr, *Trade Protection in the Millennium: The Ascendancy of Antidumping Measures*, 18 Nw. J. Int'l. L. & Bus. 49, 71 (1997) (Arguing that it does not offset the losses already suffered, but rather only rebalances benefits for the future).

member attempts to negotiate with a complaining member and pays a temporary release cost for not bringing the inconsistent measure into conformity with the WTO agreement immediately. This clearly indicates that the WTO guarantees voluntary bargaining for entitlement protection under property rules. Moreover, the WTO dispute settlement system is specifically designed to deal with ongoing violations. Particularly, the WTO surveillance procedure seems to resemble the process by which a court enforces and monitors specific performance. This strongly indicates that the WTO dispute settlement system uses the remedy of specific performance under property rules by preventing a violating member from avoiding its obligations.

I also found that WTO remedies do not resemble the liability rules of contract remedies in that they do not provide for the full compensation necessary to facilitate efficient breach. First, there are difficulties in estimating expectation damages. The determination of the level of retaliation is a mere approximation. And, systematically, the level of retaliation is primarily set from the expiration of a reasonable period of time, instead of from the time at which the violation was committed. As retaliation lacks a retroactive effect, past injuries are left uncompensated. It mainly seeks to prevent future harm to an injured member. Second, the standard of equivalence does not aim to make the price of breach relatively lower than the price of performance. Rather, it aims to establish an objective standard for determining the level of retaliation in order to prevent it from being excessive. Thus, it is not intended to undermine the purpose of compliance and to justify continued non-compliance by providing proportionate damages. In addition, there is no explicit language that allows for efficient breach in any of the WTO agreements. Moreover, it is worth mentioning that a violation will never be efficient in

the long term if it diminishes the credibility of the WTO to a considerable degree.³²⁰

However, the fact that retaliation does not provide full compensation does not mean that it cannot achieve the purpose of restoring balances since issues of balance and compensation can be resolved at different levels. While equal balance can be achieved through restoring the *status quo ante* with the raising of tariffs to their previous levels, full compensation can only be achieved by leaving an injured member in the position it would have been in had the agreement been performed. Thus, the balance of benefits between members can be restored without an injured member being fully compensated.

Finally, it should be noted that a member may confront a situation where compliance is difficult for domestic reasons. However, a state cannot violate international law because compliance would be costly or difficult in light of its domestic law or political situation. It is a long established principle of customary international law that parties to a treaty cannot rely on domestic law as justification for non-performance of treaty obligations.³²¹

³²⁰ See Michael Akehurst, *A Modern Introduction to International Law* 25 (6th ed. 1987) (Arguing that efficient breach would be a threat to treaties that are the “major instrument of international cooperation in international relations”).

³²¹ Article 27 of the Vienna Convention on Law of Treaties provides that “[a] party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.” Some argue that the political question could be avoided by using “judicial avoidance techniques.” See generally Nzelibe, *supra* note 232, at 248-250; William J. Davey, *Has the WTO Dispute Settlement System Exceeded Its Authority?: A Consideration of Deference Shown by the System to Member Government Decisions and Its Use of Issue-Avoidance Techniques*, 4 J. Int’l Econ. L. 79, 108-110 (2001); Jeffrey L. Dunoff, *The Death of the Trade Regime*, 10 Eur. J. Int’l L. 733, 754-761 (1999). Moreover, for the reason that relying on an international adjudicative system may bring an undesirable outcome, Esserman and Howse suggest that a diplomatic channel would be likely to have a better and optimal solution. See Susan Esserman & Robert Howse, *The WTO on Trial*, 82 Foreign Aff. 130, 131-140 (2003) (Suggesting that a mechanism other than resorting to a judicial means should be devised at the WTO). Howse and Staiger also argue, in case of a violating member willing to opt out from the obligation and pay appropriate damages, the consent of an injured member should still be required in order to protect its right to demand implementation. See Robert Howse & Robert W. Staiger, *United States – Anti-Dumping Act of 1916 (Original Complaint by the European Communities) – Recourse to arbitration by the United States under 22.6 of the DSU*, WT/DS136/ARB, 24 February 2004, 4 World Trade Rev. 295, 315 (2005).

Overall, from the perspective of contract remedies, WTO remedies resemble property rules of contract remedies by requiring a violating member to precisely fulfill its WTO obligations.

III. The Purpose of WTO Remedies from a Practical Perspective

In this Section, I will examine the purpose of WTO remedies from a practical perspective. There are two ways of discerning the purpose in practice. One is by examining the statements of WTO arbitrators in their decisions and the other is by examining the members' practice in their actual implementation of retaliation. In the following, I will explain them in turn.

1. Statements of Arbitrators

Absent a clear indication in the legal text of the WTO, the statements of arbitrators are arguably the most reliable references from which one can define the purpose of WTO remedies. Unfortunately, these statements can oftentimes be ambiguous, leaving room for debate. As mentioned earlier, the arbitrators once stated that “it is not completely clear what role is to be played by the suspension of obligations in the DSU and a large part of the conceptual debate that took place in these proceedings could have been avoided if a clear ‘object and purpose’ were identified.”³²²

Nevertheless, the intention of arbitrators can be inferred by putting pieces of their statements together. Two inferences can generally be drawn. First, the arbitrators have always stated that the purpose of remedies is to induce compliance. The concept of “inducing compliance” was first raised in *EC – Bananas (US) (Article 22.6 – EC)*:

³²² *US – Offset Act (Byrd Amendment) (Canada) (Article 22.6 – US)*, *supra* note 230, ¶ 6.4.

[T]he authorization to suspend concessions or other obligations is a temporary measure pending full implementation by the Member concerned. We agree with the United States that this *temporary* nature indicates that it is the purpose of countermeasures to *induce compliance*.³²³

They further stated that the purpose of inducing compliance did not mean that “the DSB should grant authorization to suspend concessions beyond what is *equivalent* to the level of nullification or impairment . . . there is nothing in Article 22.1 of the DSU . . . that could be read as a justification for countermeasures of a *punitive* nature.”³²⁴

The purpose of remedies as a means to induce compliance has been mentioned in other subsequent arbitrations. The arbitrators in *EC – Hormones (US) (Article 22.6 – EC)* agreed with the arbitrators in *EC – Bananas (US) (Article 22.6 – EC)* by recalling that “the purpose of countermeasures is to induce compliance.”³²⁵

Moreover, in cases of cross-retaliation, the arbitrators in *EC – Bananas (Ecuador) (Article 22.6 – EC)* and *US – Gambling (Article 22.6 – US)* stated that the purpose is also to induce compliance:

[T]he thrust of [effectiveness] criterion empowers the party seeking suspension to ensure that the impact of that suspension is strong and has the desired result, namely to induce compliance by the Member which fails to bring WTO-inconsistent measures into compliance with DSB rulings within a reasonable period of time.³²⁶

³²³ *EC – Bananas (US) (Article 22.6 – EC)*, *supra* note 133, ¶ 6.3 (emphasis original).

³²⁴ *Id.* (emphasis original). See also *US – Gambling (Article 22.6 – US)*, *supra* note 92, ¶ 2.7. Renouf argues that “although the requirement of equivalence may be interpreted as an implicit obligation not to impose ‘punitive’ countermeasures, it more certainly finds its origin in general international law and is formalized in the ILC Draft.” Yves Renouf, *From Bananas to Byrd: Damage Calculation Coming of Age?*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 135, 138 (Chad P. Bown & Joost Pauwelyn eds., 2010).

³²⁵ *EC – Hormones (US) (Article 22.6 – EC)*, *supra* note 129, ¶ 40.

³²⁶ *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶ 72.

Our interpretation of the “practicability” and “effectiveness” criteria is consistent with the object and purpose of Article 22 which is to induce compliance. If a complaining party seeking the DSB’s authorization to suspend certain concessions or certain other obligations were required to select the concessions or other obligations to be suspended in sectors or under agreements where such suspension would be either not available in practice or would not be powerful in effect, the objective of inducing compliance could not be accomplished and the enforcement mechanism of the WTO dispute settlement system could not function properly.³²⁷

With regard to countermeasures against prohibited subsidies, the arbitrators have consistently stated that the purpose of countermeasures is to induce compliance. The arbitrators in *Brazil – Aircraft* (Article 22.6 – *Brazil*) stated:

[W]e note that [according to the ILC Draft] countermeasures are meant to “induce [the State which has committed an internationally wrongful act] to comply with its obligations” We note in this respect that the Article 22.6 arbitrators in the *EC – Bananas* (1999) arbitration made a similar statement. We conclude that a countermeasure is “appropriate” *inter alia* if it *effectively* induces compliance.

Article 4.7 of the SCM Agreement provides in this respect that if a measure is found to be a prohibited subsidy, it shall be withdrawn without delay. In such a case, effectively “inducing compliance” means inducing the withdrawal of the prohibited subsidy.³²⁸

The arbitrators in *US – FSC* (Article 22.6 – *US*) also agreed with the arbitrators in *Brazil – Aircraft* (Article 22.6 – *Brazil*) that “countermeasures are taken against non-compliance, and thus its authorization by the DSB is aimed at inducing or securing compliance with the DSB’s recommendation.”³²⁹ Subsequently, the arbitrators in *Canada – Aircraft Credits and Guarantees* (Article 22.6 – *Canada*) agreed with the arbitrators in

³²⁷ *Id.* ¶ 76. See also *US – Gambling* (Article 22.6 – *US*), *supra* note 92, ¶¶ 4.29 & 4.84.

³²⁸ *Brazil – Aircraft* (Article 22.6 – *Brazil*), *supra* note 149, ¶¶ 3.44-3.45 (emphasis original).

³²⁹ *US – FSC* (Article 22.6 – *US*), *supra* note 142, ¶ 5.52. The arbitrators further stated that “when assessing the scope of what may be deemed ‘appropriate’ countermeasures, we should keep in mind the fact that the subsidy at issue has to be withdrawn and that a countermeasure should contribute to the ultimate objective of withdrawal of the prohibited subsidy without delay.” *Id.* ¶ 5.57.

US – FSC (Article 22.6 – US) by recalling that “the objective of the SCM Agreement in relation to Article 4.10 is to secure compliance with the DSB recommendation to withdraw the subsidy.”³³⁰

Interestingly, they decided to add 20 per cent to the amount of subsidy as the level of countermeasures. This raised a concern that the “appropriateness” standard may provide a justification for countermeasures of a punitive nature. However, although the standard provides some flexibility in assessing the level of countermeasures, the arbitrators repeatedly underlined that the higher level of countermeasures was aimed at inducing compliance.³³¹ In my view, such amounts were considered because the amount of the subsidy itself in this case was substantially lower than its trade effect.³³² By reading the decision, it is quite clear that it was not the intent of the arbitrators to authorize punitive countermeasures. As the arbitrators in *US – FSC (Article 22.6 – US)* stated, there is “nothing in the text or in its context which suggests an entitlement to manifestly punitive measures.”³³³

Most recently, when the level of countermeasures was determined based on the trade effect, the arbitrators in *US – Upland Cotton (Article 22.6 – US)* confirmed that “countermeasures under Article 4.10 of the *SCM Agreement* serve to ‘induce

³³⁰ *Canada – Aircraft Credits and Guarantees (Article 22.6 – Canada)*, *supra* note 140, ¶ 3.105.

³³¹ *See id.* ¶¶ 3.107 & 3.121.

³³² *See* Renouf, *supra* note 324, at 138-139. Ethier argues that the principle of proportionality, such as the “appropriateness” or “equivalence” standard, renders punitive damages logically incompatible. *See* W. J. Ethier, *Punishment and Dispute Settlement in Trade Agreement* (Penn Inst. for Econ. Research, Working Paper No. 01-21, 2001), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=273212.

³³³ *US – FSC (Article 22.6 – US)*, *supra* note 142, ¶ 5.62. For a view of suggesting punitive retaliation, see March L. Busch & Eric Reinhardt, *Testing International Trade Law: Empirical Studies of GATT/WTO Dispute Settlement*, in *The Political Economy of International Economic Law* 457 (D. Kennedy & J. Southwick eds., 2002) (Arguing that resolving the problem of non-compliance requires “stiffer penalties and speedier legal authorization”). *See also* Kim Richard Nossal, *International Sanctions as International Punishment*, 43 *Int’l Org.* 301 (1989).

compliance.”³³⁴

With regard to countermeasures against actionable subsidies, they also stated that the purpose of countermeasures is to induce compliance:

As under Article 22.4 of the DSU and Article 4.10 of the *SCM Agreement*, countermeasures under Article 7.9 of the *SCM Agreement* constitute temporary measures taken in response to a continued breach of the obligations of the Member concerned, and pending full compliance with the recommendations and rulings of the DSB. We consider, therefore, that countermeasures under Article 7.9 of the *SCM Agreement* also serve to “induce compliance.”³³⁵

Second, the arbitrators in two arbitration proceedings left room for discussion on whether WTO remedies may serve other purposes. Although the arbitrators in *US – 1916 Act (EC) (Article 22.6 – US)* agreed that a fundamental purpose of retaliation is to induce compliance, they also acknowledged that there may be other considerations taken into account:

[I]n our view, a key objective of the suspension of concessions or obligations – *whatever other purposes may exist* – is to seek to induce compliance by the other WTO Member with its WTO obligations.³³⁶

The arbitrators in *US – Offset Act (Byrd Amendment) (Canada) (Article 22.6 – US)* went even further by stating that they were uncertain whether inducing compliance was the exclusive purpose of retaliation:

The concept of “inducing compliance” . . . is not expressly referred to in any

³³⁴ *US – Upland Cotton (Article 22.6 – US)*, *supra* note 96, ¶ 4.112 (emphasis original).

³³⁵ *US – Upland Cotton (Article 22.6 – US II)*, *supra* note 150, ¶ 4.59 (emphasis original).

³³⁶ *US – 1916 Act (EC) (Article 22.6 – US)*, *supra* note 130, ¶ 5.5 (emphasis added).

part of the DSU and we are not persuaded that the object and purpose of the DSU . . . would support an approach where the purpose of suspension of concessions or other obligations pursuant to Article 22 would be exclusively to induce compliance . . . we cannot exclude that inducing compliance is part of the objectives behind suspension of concessions or other obligations, but at most it can be only one of a number of purposes in authorizing the suspension of concessions or other obligations. By relying on “inducing compliance” as the benchmark for the selection of the most appropriate approach we also run the risk of losing sight of the requirement of Article 22.4 that the level of suspension be *equivalent* to the level of nullification or impairment.³³⁷

In this regard, they concluded that retaliation may simultaneously serve the purpose of inducing compliance and providing some form of temporary compensation:

[T]he DSU does not expressly explain the purpose behind the authorization of the suspension of concessions or other obligations. On the one hand, the general obligation to comply with DSB recommendations and rulings seems to imply that suspension of concessions or other obligations is intended to induce compliance, as has been acknowledged by previous arbitrators.

On the other hand, the requirement that the level of such suspensions remain equivalent to the level of nullification or impairment suffered by the complaining party seems to imply that suspension of concessions or other obligations is only a means of obtaining some form of temporary compensation, even when the negotiation of compensation has failed.³³⁸

What can be extracted from the statements of arbitrators? At least one thing is clear: the arbitrators in all cases recognized that inducing compliance is a purpose of WTO remedies. They generally focused on the temporary nature of retaliation pending full compliance by the members concerned. Although, as mentioned above, it has once been stated that retaliation may serve to provide some form of compensation, the arbitrators clearly expressed the view that compensation is a temporary measure and that a violating

³³⁷ *US – Offset Act (Byrd Amendment) (Canada) (Article 22.6 – US)*, *supra* note 230, ¶ 3.72 (emphasis original).

³³⁸ *Id.* ¶¶ 6.2-6.3.

member is still required to bring its inconsistent measure into conformity with its WTO obligations.

2. Retaliation Practice

Another method of discerning the purpose of remedies is by examining the members' retaliation practice. Generally, the design of retaliatory actions reveals what the members are trying to achieve through retaliation.³³⁹ As I explain below, it appears that members design their retaliatory actions in order to induce compliance. This can be seen in two respects.

First, the targets of retaliation seem to be chosen to induce compliance. Retaliating members typically target the strongest supporters of the original violation and the products of politically influential exporters so as to pressure them into lobbying their governments for compliance. If a retaliating member were merely aiming to restore the balance of benefits between members, it would have targeted a broad range of products rather than strategically target a small number of politically influential exporters.³⁴⁰

In *EC – Bananas*, the US drafted a retaliation list of non-agricultural products designed to put pressure on particular EC members, mainly the UK and France, which were the leading supporters of the banana regime.³⁴¹ Products from Denmark and the

³³⁹ For an excellent analysis on members' retaliation practice, see Gregory Shaffer & Daniel Ganin, *Extrapolating Purpose from Practice: Rebalancing or Inducing Compliance*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 73 (Chad P. Bown & Joost Pauwelyn eds., 2010).

³⁴⁰ Of course, one may question the efficiency of such retaliation. However, it seems to be designed to send a political message that the violating member should comply with its obligations, rather than having an actual economic impact. See Vasken Khabayan, *Canada's Experience and Practice in Suspending WTO Obligations*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 277, 278-279 (Chad P. Bown & Joost Pauwelyn eds., 2010).

³⁴¹ See Scott D. Anderson & Justine Blanchet, *The United States' Experience and Practice in Suspending WTO Obligations*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 235, 238 (Chad P. Bown & Joost Pauwelyn eds., 2010).

Netherlands were exempted from the list because they were generally against the new banana import regime within the EU. The items on the list were handbags, cotton bed linen, lead-acid storage batteries, coffee makers, bath preparations, wallets, uncoated felt paper, cartons, and lithographs.³⁴² In *EC – Hormones*, the US targeted high-end agricultural products from France, Germany, Italy, and Denmark, which were the strongest supporters of the hormone ban. Retaliation was imposed mainly on Roquefort cheese, French mustard, and Danish ham.³⁴³ In the middle of the implementation process, pork products from Denmark were removed from the retaliation list because Denmark appeared to wield less political influence.³⁴⁴ In *US – Offset Act (Byrd Amendment)*, although the main beneficiaries of the Byrd Amendment were producers of ball bearings, steel and other metal, household items, and some food products, Canada targeted items such as live swine, cigarettes, oysters, and certain specialty fish, such as ornamental fish or certain frozen fish like monkfish or tilapia. These products were selected because the strongest supporters of the Byrd legislation were from Virginia and Maine and these products were from their districts.³⁴⁵ In *US – Steel Safeguards*, the EC threatened to impose retaliation on products such as steel from Pennsylvania and orange juice from Florida, which were politically critical states for the 2004 presidential elections.³⁴⁶ Those

³⁴² See Gary G. Yerkey & Daniel Pruzin, *U.S. Issues Final List of European Imports to Be Hit with Higher Duties in Banana Row*, 16 Int'l Trade Rep. (BNA) 621 (Apr. 14, 1999).

³⁴³ See Gary G. Yerkey, *U.S. Beef Producers Propose Easing Trade Sanctions against EU in Meat Dispute*, 17 Int'l Trade Rep. (BNA) 1554 (Oct. 12, 2000); Gary G. Yerkey, *U.S. Announces Final List of EU Imports Targeted for Higher Duties in Beef Dispute*, 16 Int'l Trade Rep. (BNA) 1212 (Jul. 21, 1999). See also Anderson and Blanchet, *supra* note 341, at 240.

³⁴⁴ See Charnovitz, *supra* note 215, at 815. See also Rosemary A. Ford, *The Beef Hormone Dispute and Carousel Sanctions: A Roundabout Way of Forcing Compliance with World Trade Organization Decisions*, 27 Brook. J. Int'l L. 543, 568 (2002).

³⁴⁵ See Khabayan, *supra* note 340, at 278. See also Rossella Brevetti & Michael O'Boyle, *EC, Canada Move to Impose Retaliatory Duties in Byrd Dispute*, 22 Int'l Trade Rep. (BNA) 546 (Apr. 7, 2005).

³⁴⁶ See Hakan Nordstrom, *The Politics of Selecting Trade Retaliation in the European Community: A View from the Floor*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 267, 268 (Chad P. Bown & Joost Pauwelyn eds., 2010); Lothar Ehring, *The European Community's Experience and*

products were targeted instead of the US steel products that were directly benefitting from the WTO-inconsistent safeguard measure. Likewise, in *US – FSC*, apparel and footwear products were selected for the retaliation list, although they had not benefitted from the tax breaks.³⁴⁷

Second, the method of implementing retaliation was aimed at inducing compliance. There have been instances where retaliating members attempted to change the retaliation list or increase the level of retaliation over time. Retaliating members attempted to change their method of implementation to exert greater pressure on the violating members to comply. If retaliating members were merely aiming to restore the balance of benefits between members, they would have sought to implement the full amount without any changes to their implementation method.

In *EC – Bananas* and *EC – Hormones*, when the EC strongly resisted compliance notwithstanding long-standing US retaliation, the US sought to vary the products on the retaliation list through the so-called “carousel” provision to exert maximum pressure on the EC to comply with WTO decisions. The US Congress enacted this provision in order to enhance the effectiveness of retaliation. It required the USTR to revise the list of

Practice in Suspending WTO Obligations, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 244, 248 (Chad P. Bown & Joost Pauwelyn eds., 2010). See also Rossella Brevetti, Christopher S. Rugaber, Daniel Pruzin & Toshio Aritake, *Lifting of Steel Safeguard Tariffs by U.S. Would Generate Legal, Political Challenges*, 20 Int’l Trade Rep. (BNA) 1985 (Dec. 4, 2003); Joe Kirwin, *EU Members Back EC Proposal to Delay ‘Short List’ Sanctions on U.S. Steel Tariffs*, Int’l Trade Daily (BNA) (Oct. 1, 2002); Gary G. Yerkey, *EU Draws Up List of U.S. Products Targeted for Sanctions in Steel Dispute*, 19 Int’l Trade Rep. (BNA) 526 (Mar. 28, 2002).

³⁴⁷ See Daniel Pruzin, *EU Submits List of U.S. Imports to Be Hit with Possible Duties in FSC/ETI Dispute*, Int’l Trade Daily (BNA) (Apr. 29, 2003); Gary G. Yerkey, *U.S. Companies Plan All-Out Effort Seeking to Remove Products from EU Retaliation List*, Int’l Trade Daily (BNA) (Sept. 16, 2002).

targeted products every 6 months.³⁴⁸ Although the “carousel” provision has yet to be implemented, it is still being considered.³⁴⁹

In *US – FSC*, the EC used a different method to implement retaliation. It imposed incremental or partial retaliation, instead of implementing the full amount of retaliation. It imposed an additional 5 per cent import duty and increased it by 1 per cent every month for a period of one year, or until the duty level reached 17 per cent.³⁵⁰ In *US – Offset Act (Byrd Amendment)*, it implemented retaliation in the form of an additional 15 per cent duty which the Commission adjusted each year in order to ensure a level of equivalence between the retaliation imposed and the latest annual disbursement under the Byrd Amendment.³⁵¹ Ehring terms this form of retaliation as “smart sanctions” which offer advantages both in terms of minimizing domestic harm and inducing compliance. He argues that increasing the level of retaliation over time would be useful in the sense that “a frustrated exporter can have a more powerful voice domestically than an eliminated exporter that has gone out of business entirely or that has lost a certain export market without hope of re-conquering it quickly.”³⁵²

³⁴⁸ See Trade and Development Act of 2000, Pub. L. No. 106-200, 114 Stat. 251. See also Gary G. Yerkey, *U.S. Meat Industry Expresses Concern about Delay in Publication of ‘Carousel’ List*, 17 Int’l Trade Rep. (BNA) 1402 (Sept. 14, 2000).

³⁴⁹ Gary G. Yerkey, *USTR Seeks Input on Possible Change to Sanctions in Beef Trade Dispute with EU*, 25 Int’l Trade Rep. (BNA) 1576 (Nov. 6, 2008). Robert Zoellick, the US Trade Representative at that time, asserted that the “carousel” provision had been already successful in inducing compliance without actually using it. He further argued that it could be used as a form of leverage in other instances. See Gary G. Yerkey, *U.S. Will Use ‘Carousel’ Law as ‘Leverage’ to Open Foreign Markets*, USTR Zoellick Says, 18 Int’l Trade Rep. (BNA) 850 (May 31, 2001). Likewise, when the US resisted compliance notwithstanding long-standing retaliation, Mexico released a revised list of products for retaliation to achieve full compliance by the US with its commitments under the North American Free Trade Agreement (NAFTA). See Rossella Brevetti, *Kirk Disappointed Mexico Imposing Additional Duties in Trucking Dispute*, 27 Int’l Trade Rep. (BNA) 1268 (Aug. 19, 2010).

³⁵⁰ See Ehring, *supra* note 346, at 249.

³⁵¹ *Id.* at 252. See also Brevetti & O’Boyle, *supra* note 345.

³⁵² See Ehring, *supra* note 346, at 255-256.

In addition, as repeatedly underlined, there have also been instances where developing country members sought to cross-retaliate because retaliation in the same sector would be ineffective in terms of inducing compliance.³⁵³ They especially attempted to target intellectual property rights which were politically sensitive issues in order to incentivize those affected groups to lobby their governments for compliance.³⁵⁴

Overall, current practice clearly shows that retaliating members have targeted the strongest supporters of the original violation or politically influential exporters to lobby their governments for compliance. Moreover, they have attempted to change their method of implementation in the form of rotating the retaliation list, increasing the level over time, and retaliating in other sectors or agreements to put more pressure on the violating members for compliance. If retaliating members were merely aiming to restore the balance of benefits between members or to compensate their injured domestic parties, they would have rather implemented retaliation for the full amount they were allotted or retaliated against those products that compete with the domestic industry harmed by the original violation.

Recently, in *US – Upland Cotton*, Brazil released a list of US products and intellectual property measures which were sensitive targets subject to retaliation.³⁵⁵ However, Brazil decided to delay the implementation of its retaliation. Instead, Brazil used the threat of retaliation to get the US to agree to change certain measures and to

³⁵³ See Ed Taylor, *Brazil Releases List of Intellectual Property Retaliation Measures in U.S. Cotton Dispute*, 27 Int'l Trade Rep. (BNA) 394 (Mar. 18, 2010) [hereinafter Taylor, IP List]; Daniel Pruzin & Joe Kirwin, *WTO Allows Antigua to Impose \$21 Million in Sanctions Yearly in U.S. Gambling Dispute*, 25 Int'l Trade Rep. (BNA) 6 (Jan. 3, 2008); Daniel Pruzin, *WTO Authorizes Ecuador to Retaliate Against EU in Dispute over Banana Imports*, 17 Int'l Trade Rep. (BNA) 474 (Mar. 23, 2000).

³⁵⁴ See Shaffer & Ganin, *supra* note 339, at 84-85.

³⁵⁵ See Taylor, IP List, *supra* note 353; Ed Taylor, *Brazil Issues List of 102 U.S. Products Subject to Sanctions due to Cotton Case*, 27 Int'l Trade Rep. (BNA) 328 (Mar. 11, 2010) [hereinafter Taylor, 102 US Products].

establish a fund for technical assistance and capacity building related to the cotton sector in Brazil as temporary compensation.³⁵⁶ This fund was scheduled to continue and the implementation of retaliation remained suspended until the US complied with the DSB recommendations or a mutually agreed solution to the dispute was reached.³⁵⁷

With regard to *US – FSC*, Lamy, who was the EU Trade Commissioner at that time, stated that “[t]he fundamental EU objective is . . . to ensure the repeal of the WTO incompatible . . . legislation which provides an illegal export subsidy. However . . . if the compliance process does not deliver swift results, the Commission will not hesitate to propose the adoption of countermeasures.”³⁵⁸

3. Concluding Remarks

In this Section, I examined the purpose of WTO remedies from a practical perspective. First, with regard to the statements of arbitrators, although their statements are at times ambiguous, they have consistently stated that one of the purposes, if not the sole purpose, of WTO remedies is to induce compliance. They generally focused on the nature of retaliation in that it is a temporary measure pending full compliance with WTO obligations. Second, with regard to members’ practice, they use retaliation to induce compliance by specifically tailoring their target and implementation method. They generally targeted the strongest supporters of the original violation and the products of politically influential foreign exporters, who would be most inclined to lobby their

³⁵⁶ See Ed Taylor, *Brazil Delays Sanctions against U.S. in WTO Cotton Dispute for Another 60 Days*, 27 Int’l Trade Rep. (BNA) 634 (Apr. 29, 2010).

³⁵⁷ See Daniel Pruzin, *U.S. Agrees to Make More Changes in Export Program to Avoid Brazil Sanctions*, 27 Int’l Trade Rep. (BNA) 951 (Jun. 24, 2010); Ed Taylor, *Brazil Suspends Sanctions against U.S. until 2012 in WTO Cotton Subsidy Dispute*, 27 Int’l Trade Rep. (BNA) 950 (Jun. 24, 2010).

³⁵⁸ Joe Kirwin & Alison Bennett, *EU Issues List of Up to \$15 Billion in U.S. Exports Facing Possible Sanctions*, 19 Int’l Trade Rep. (BNA) 1576 (Sept. 19, 2002).

governments for compliance. Moreover, they attempted to change their method of implementation by varying the retaliation list, increasing the level over time and retaliating in other sectors or agreements to exert greater pressure on the violating members for compliance.

Overall, current practice clearly indicates that inducing compliance is the purpose of WTO remedies.

IV. Conclusion

The debate on the purpose of WTO remedies has lasted for more than a decade because the DSU does not clearly specify its purpose. Nevertheless, it is important to define and understand what WTO remedies pursue as their purpose in order to design and propose effective remedies because different purposes require different means to achieve them.

In this chapter, I attempted to find the purpose of WTO dispute settlement remedies by looking at them from historical, contractual and practical perspectives. In Section I, I examined the purpose of WTO remedies from a historical perspective and discovered that the concept and structure of remedies have changed from GATT to the WTO. While the purpose of remedies under GATT was simply to restore the balance of benefits between the parties to a dispute, the purpose of inducing compliance has been added in the WTO. The legal transformation toward enforcement created the purpose of inducing compliance in WTO remedies along with the purpose of restoring the balance of reciprocal benefits to the members in a dispute.

In Section II, I examined the purpose of WTO remedies from a contractual perspective. I discovered that WTO remedies are closer to the property rules of contract remedies, guaranteeing voluntary bargaining for entitlement protection. In the situation of both providing compensation and implementing retaliation, a violating member attempts to negotiate with a complaining member and pays a temporary release cost for not bringing the inconsistent measure into conformity with WTO obligations immediately. In addition, I found that WTO remedies do not resemble the liability rules of contract remedies in that they do not provide full compensation in order to facilitate efficient breach. The determination of the level of retaliation is a mere approximation and, systematically, its level is primarily set from the expiration of a reasonable period of time, leaving past injuries uncompensated. However, the fact that retaliation does not provide full compensation does not mean that it cannot serve the purpose of restoring balance. Restoring balance and providing compensation can be achieved at different levels. While equal balance can be achieved through restoring the *status quo ante* through the raising of tariffs to the previous level, the full level of compensation can only be attained by leaving an injured member in a position where it would have been had the agreement been performed. Thus, the balance of benefits between members can be restored without an injured member being fully compensated. Overall, WTO remedies resemble property rules of contract remedies requiring a violating member to precisely fulfill its WTO obligations.

In Section III, I examined the purpose of WTO remedies from a practical perspective. I discovered that current practice clearly indicates that inducing compliance is the purpose of WTO remedies. With regard to the statements of arbitrators, they have, in all

cases, agreed that a purpose of WTO remedies was to induce compliance. They generally focused on the fact that retaliation is a temporary measure pending full compliance with WTO obligations. With regard to members' retaliation practice, they designed their retaliation in order to induce compliance by specifically tailoring the targeted products and varying the implementation method of retaliation.

In light of the above, I have reached three conclusions. They are as follows:

- (1) WTO remedies may provide some form of temporary compensation and may restore the balance between disputing members.*
- (2) However, the WTO intends to maintain that balance only through compliance, not through violation-cum-compensation or violation-cum-retaliation.*³⁵⁹
- (3) Therefore, the ultimate purpose of WTO remedies is to induce compliance.*

As stated in Article 3.2 of the DSU, the WTO dispute settlement system is meant to provide security and predictability to international trade relations. If a member were simply exempted from WTO obligations by providing compensation or accepting retaliation, it would seriously undermine these fundamental objectives.³⁶⁰ A dispute in WTO dispute settlement is resolved only when the violating member complies with the decision of the WTO adjudicative system and fulfils its obligations under the relevant WTO agreements. In this sense, WTO remedies as compensation or retaliation are not alternative options to compliance, but rather tentative remedies for the delay in

³⁵⁹ In the same vein, the arbitrators in *US – FSC (Article 22.6 – US)* stated that “the balance of rights and obligations between Members will only ultimately be properly redressed through full compliance with the DSB's recommendations” *US – FSC (Article 22.6 – US)*, *supra* note 142, ¶ 6.9 n.72.

³⁶⁰ See Marco C. E. J. Bronckers, *More Power to the WTO?*, 4 J. Int'l Econ. L. 41, 61 (2001) (Arguing that “it is not possible to build a credible system of global governance, if compliance with any governing rule can simply be replaced with compensation. There is a good reason why public international law does not recognize this easy way out”).

implementation pending full compliance with WTO obligations.

In the next Chapter, I will propose improvements to the currently available WTO dispute settlement remedies. To this end, I will take into account the purpose of inducing compliance and the problems with remedies, which were discussed in Chapter 2.

CHAPTER 4: IMPROVEMENT OF WTO DISPUTE SETTLEMENT REMEDIES

This Chapter proposes possible improvements to WTO dispute settlement remedies. To date, various alternatives to the remedies have been proposed. Yet, they should be considered carefully, as they present not only advantages but disadvantages, which may make them untenable. It is important that proposed remedies accomplish their ultimate purpose, which is to induce compliance, and, if possible, help to solve, or at least minimize, the problems that were considered in the previous Chapters.³⁶¹

Primarily, solutions to the problem of non-compliance should focus on strengthening the current system of remedies themselves. In Section I, I will reconstruct the current system of retaliation. In particular, I suggest some degree of retroactivity in determining the level of retaliation, changes in the method of implementing retaliation, the possibility of collective retaliation and the use of monetary payments as an additional tool of compliance enforcement. I will also underline the importance of TRIPS retaliation. In Section II, I will consider the more extensive use of the current system of compensation, as it is a preferable remedy to retaliation. In Section III, I will conclude with some comments.

I. Reconstruction of Retaliation

In this Section, I will focus on the improvement of the current system of retaliation, which is the remedy of last resort. I suggest practical improvements that could achieve the purpose of inducing compliance and help overcome the power imbalances that exist in international trade relations.

³⁶¹ For the discussion on the problems of WTO remedies, see Ch. 2. Sec. II. 5.

1. Introducing Retroactive Retaliation

In practice, the level of retaliation is determined as of the expiration of the reasonable period of time for implementation, with retaliation applied prospectively.³⁶² In other words, a requesting member may not retaliate with respect to damage suffered prior to the expiration of the reasonable period of time. Thus, until the expiration of the reasonable period of time, an inconsistent measure can be maintained without cost.

Accordingly, the prospective nature of retaliation provides no incentive for “prompt compliance” with WTO rulings.³⁶³ Rather, it perversely may encourage the violating member to delay compliance by seeking a long reasonable period of time, taking unsatisfactory implementation measures that inevitably lead the complainant to resort to compliance review under Article 21.5 and requesting an arbitration proceeding under Article 22.6.³⁶⁴

Thus, in order to create incentives for prompt compliance and discourage delay, one solution would be to determine the level of retaliation from any date prior to the date currently set for implementation.³⁶⁵ Mexico has proposed a determination of the level of retaliation that could start at any of the following moments in time: (1) the date of imposition of the measure; (2) the date of the request for consultations; or (3) the date of establishment of the panel. In Mexico’s view, this would fairly allocate the balance of

³⁶² See *EC – Bananas (US)* (Article 22.6 – EC), *supra* note 133, ¶ 38; *EC – Bananas (Ecuador)* (Article 22.6 – EC), *supra* note 92, ¶ 6.105; *Brazil – Aircraft* (Article 22.6 – Brazil), *supra* note 149, ¶¶ 3.63-3.65; *US – FSC* (Article 22.6 – US), *supra* note 142, ¶¶ 2.12-2.15; *Canada – Aircraft Credits and Guarantees* (Article 22.6 – Canada), *supra* note 140, ¶ 3.67. However, it is interesting that WTO practice recognizes retaliation only as prospective, although the DSU does not disallow retroactive retaliation textually.

³⁶³ See DSU art. 21.1.

³⁶⁴ See Won-Mog Choi, *To Comply or Not to Comply? – Non-implementation Problems in the WTO Dispute Settlement System*, 41 J. World Trade 1043, 1063 (2007); William J. Davey, *Reforming WTO Dispute Settlement* 37 (Ill. Pub. Law & Legal Theory Research Paper Series, Research Paper No. 04-01, 2004), available at <http://ssrn.com/abstract=495386>.

³⁶⁵ See Davey, *supra* note 222.

concessions and rights.³⁶⁶

However, a number of countries and scholars are highly concerned about introducing retroactivity into the system. Canada, for example, has expressed reservations that it may not respect the right of members to seek a reasonable period of time in cases where immediate implementation is not practicable.³⁶⁷ Choi also strongly opposes determination of the level of retaliation so as to include a time period that starts before the date of the legal obligation for compliance because it would merely justify punitive retaliation, which would violate the basic principles of the DSU.³⁶⁸

However, in my view, a determination of retaliation so as to include time periods before the expiration of the reasonable period of time for implementation does not disregard the right to a reasonable period of time, since retaliation is implemented after such a period has expired. Accordingly, the purpose of introducing “retroactive” retaliation is to create incentives for prompt compliance or, at least, compliance within the reasonable period of time. There is no intent to strip the right of a member to such a period.

The earliest time from which to assess the level of retaliation could be when the inconsistent measure came into force, which may coincide with when it began to cause injury, and the latest appropriate point of assessment could be set at the adoption of the panel or Appellate Body report. Although there may be a preference for one moment over

³⁶⁶ See Special Session of the Dispute Settlement Body, *Negotiations on Improvement and Clarifications of the Dispute Settlement Understanding, Proposal by Mexico*, TN/DS/W/23 (Nov. 4, 2002) [hereinafter Mexican Proposal]. See also Special Session of the Dispute Settlement Body, *Amendments to the Understanding on Rules and Procedures Governing the Settlement of Disputes Proposed Text by Mexico, Communication from Mexico*, TN/DS/W/40 (Jan. 27, 2003) [hereinafter Mexican Text].

³⁶⁷ See Special Session of the Dispute Settlement Body, *Minutes of Meeting, Held in the Centre William Rappard on 13 – 15 November 2002*, ¶ 38, TN/DS/M/6 (Mar. 31, 2003) [hereinafter TN/DS/M/6].

³⁶⁸ See Choi, *supra* note 364, at 1064 (Arguing that “obligations to bring the measure into WTO conformity do not arise during [the reasonable period of time]”).

the other, it is important to note that any proposed moment before the expiration of the reasonable period of time would create incentives for compliance and discourage delay. In my view, in the sense that the DSU calls for “prompt compliance,” which requires a violating member to implement the WTO ruling as soon as the panel or Appellate Body report has been adopted, the level of retaliation should be measured, at a minimum, as of the adoption of these reports.³⁶⁹ This may provide strong incentives for the violating member to comply immediately upon the adoption of such reports.

Although retroactive remedies occasionally have been granted in trade remedy cases to a limited extent,³⁷⁰ introducing “retroactive” retaliation under the DSU is a novel idea that has never been authorized by the DSB. Therefore, it requires a careful examination in deciding which moment would be the most optimal starting point for determining the level of retaliation.

2. Changing the Method of Implementation

While it may be true that a higher level of retaliation would create more incentives for

³⁶⁹ See Ch. 2. Sec. II. 1.1. See also William J. Davey, *Sanctions in the WTO: Problems and Solutions*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 360, 366 (Chad P. Bown & Joost Pauwelyn eds., 2010). From the three moments proposed by Mexico, Shadikhodjaev argues that the date of the request for consultations seems most reasonable in the sense that it would create more incentives to reach a mutually satisfactory solution before the stage of panel proceeding. See Shadikhodjaev, *supra* note 304, at 170.

³⁷⁰ The panel in *Australia – Automotive Leather* not only recommended the withdrawal of the subsidy but also ordered the full repayment of the subsidy. The reasoning behind this decision was that the term “withdraw the subsidy” may not encompass repayment and this would raise “serious questions regarding the efficacy of the remedy in prohibited subsidy cases involving one-time subsidies paid in the past.” The panel distinguished Article 4.7 of the SCM Agreement from Article 19.1 of the DSU by stating that the former is not limited to “purely prospective action.” Accordingly, it essentially permitted a “retrospective” remedy with respect to prohibited subsidies. See Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather, Recourse to Article 21.5 of the DSU by the United States*, ¶¶ 6.31, 6.35 & 6.39-6.42, WT/DS126/RW (Jan. 21, 2000). However, this decision has been intensely criticized for exceeding the panel’s mandate under the DSU. See, e.g., Gavin Goh & Andreas R. Ziegler, *Retrospective Remedies in the WTO after Automotive Leather*, 6 J. Int’l Econ. L. 545, 549-551 (2003). As mentioned previously, in GATT, retroactive remedies were also provided in a few cases dealing with antidumping and countervailing duties. See Ch. 2. Sec. I. 2.1. n.22.

compliance, as seen in practice, it is not so much the amount of retaliation that matters, but rather the implementation method of retaliation. Even where retaliation may lack an economic impact, it is important to study how retaliatory measures could send a strong political message by formulating its implementation method to enforce compliance.

I strongly propose the rotation of retaliation targets and gradual changes of the level of retaliation over time as follows.

2.1. Rotating the Retaliation List

The list of products subject to retaliation could be rotated periodically to impose greater impact on the violating member. The advantage of such rotation is that, while exporters subject to retaliation remain on the list for a short period, it redistributes “the harm in such a way that its impact is individually lessened, though affecting more businesses.”³⁷¹ Thus, by increasing the number of exporting industries that are affected by retaliation, there may be more interested groups willing to pressure the violating member’s government into compliance.

In *EC – Hormones (US) (Article 22.6 – EC)*, the EC raised an objection to the statement made by the USTR that the US is free to resort to such rotation “where the concessions and other obligations subject to suspension would change every now and then, in particular in terms of product coverage.”³⁷² The EC argued that in doing so the US would unilaterally decide not only which concessions or obligations to suspend, but also whether the level of such suspension meets the standard of equivalence required by Article 22.4 of the DSU. In response, the US stated that “[a]lthough nothing in the DSU

³⁷¹ Ford, *supra* note 344, at 549.

³⁷² *EC – Hormones (US) (Article 22.6 – EC)*, *supra* note 129, ¶ 22.

prevents future changes to the list [of products subject to suspension] ..., the United States has no current intent to make such changes.” Hence, the arbitrators concluded that it was not necessary to consider such an issue in determining the level of retaliation.³⁷³

Nevertheless, when the EC continued to maintain its inconsistent measures in *EC – Bananas* and *EC – Hormones*, the US Congress enacted Section 407 of Trade and Development Act of 2000, otherwise known as the “carousel” provision. It requires the USTR to modify the list of products to which retaliation applies on a regular basis. In particular, it was designed to revise the list of products after 120 days of the first application of suspension and then every 180 days thereafter in order to affect imports from members that have been determined by the US not to have implemented WTO recommendations.³⁷⁴

The EC strongly opposed this provision and requested consultations on grounds that (1) it is a “unilateral action without any prior multilateral control” that “mandates suspension of or threatens to suspend concessions or other obligations other than those on which authorization was granted by the DSB”; (2) it creates a “structural imbalance between the cumulative level of the suspensions of concessions and the level of nullification and impairment” which is in breach of the standard of equivalence under the DSU; and (3) it creates a “‘chilling effect’ on the market-place, thus gravely affecting the security and predictability of the multilateral trading system.”³⁷⁵

However, this dispute has not yet moved beyond the consultation stage, which is

³⁷³ See *id.* ¶ 22.

³⁷⁴ See Trade and Development Act of 2000, Pub. L. No. 106-200, § 407, 114 Stat. 251, 293-294. However, there were some concerns from many US industries that the carousel provision would create “confusion and hardship for retailers and small and mid-sized businesses by continually raising and lowering tariffs.” See Anderson and Blanchet, *supra* note 341, at 237.

³⁷⁵ See Request for Consultations by the European Communities, *United States – Section 306 of the Trade Act of 1974 and Amendments Thereto*, WT/DS200/1 & G/L/386 (Jun. 13, 2000).

partly due to the fact that the US has not applied the provision. As such, to date, no such rotation of products on a retaliation list has occurred.

The question under consideration here is whether the rotation of products on a retaliation list under the “carousel” provision is legitimate. There are two instances in which the rotation of products on a retaliation list would be permissible. First, in the event of suspension of tariff concessions, if the retaliation list is modified within the scope of the sectors authorized by the DSB, such rotation would be legitimate.

Currently, although it is not required by the DSU textually, it has become standard practice to submit a retaliation list at the time a request for the authorization of retaliation is made.³⁷⁶ It is for the retaliating member to draw up the retaliation list that can be subject to suspension and to ensure the level of retaliation does not exceed the level of nullification or impairment.³⁷⁷ A requesting member typically issues a broad and provisional retaliation list in order to create uncertainty among exporters within the violating member state, which thereby incentivizes them to lobby their government to comply. Thus, it maximizes pressure by increasing widespread apprehension among

³⁷⁶ In total, there were six cases where members were authorized to suspend tariff concessions. Five of them have submitted the list of products for suspension at the time of request for authorization. *See* Recourse by Brazil to Article 4.10 of the Agreement on Subsidies and Countervailing Measures and Article 22.2 of the Understanding on Rules and Procedures Governing the Settlement of Disputes, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/7 (May 24, 2002); Recourse by the European Communities to Article 4.10 of the SCM Agreement and Article 22.2 of the DSU, *United States – Tax Treatment for “Foreign Sales Corporations,”* WT/DS108/13 (Nov. 17, 2000); Recourse by Canada to Article 4.10 of the SCM Agreement and Article 22.2 of the DSU, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/16 (May 11, 2000); Recourse by the United States to Article 22.2 of the DSU, *European Communities – Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/19 (May 18, 1999); Recourse by the United States to Article 22.2 of the DSU, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/43 (Jan. 14, 1999). In one case where the list has not been submitted, the requesting member, Canada, however, stated that it will notify to the DSB a final list each year prior to the imposition of the additional duties. *See* Recourse by Canada to Article 22.2 of the DSU, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS234/25 (Jan. 16, 2004). *See also* *US – Offset Act (Byrd Amendment) (Canada) (Article 22.6 – US)*, *supra* note 230, ¶ 2.22.

³⁷⁷ *See EC – Hormones (US) (Article 22.6 – EC)*, *supra* note 129, ¶ 23.

possible targets.³⁷⁸ It also creates pressure before the actual retaliation takes place.

The arbitrators in *EC – Hormones (US) (Article 22.6 – EC)* clearly stated that, in the event of suspension of tariff concessions, “only products that appear on the product list attached to the request for suspension can be subject to suspension.”³⁷⁹ And, the requesting member may freely “pick products from that list – not outside the list – equaling a total trade value that does not exceed the amount of trade impairment”³⁸⁰ Thus, the legitimacy of “carousel” retaliation depends on whether a retaliation list has been submitted to and authorized by the DSB. It is up to the discretion of the requesting member to decide which items to target within the scope of authorized products.³⁸¹

Second, there may be instances where a requesting member intends to rotate the list of products that are not submitted to or authorized by the DSB. This seems to be permissible so long as there are procedures which ensure that the level of retaliation does not exceed the level of nullification or impairment.³⁸²

³⁷⁸ See Shaffer & Ganin, *supra* note 339, at 79; Ehring, *supra* note 346, at 252.

³⁷⁹ *EC – Hormones (US) (Article 22.6 – EC)*, *supra* note 129, ¶ 16. They argued on the ground that this “follows from the minimum requirements attached to a request to suspend concessions or other obligations.” *Id.*

³⁸⁰ *Id.* ¶ 21.

³⁸¹ In the event of suspension of other, non-tariff obligations, if the obligations are rotated within the agreements authorized by the DSB, such rotation would be legitimate. In practice, except for the suspension of certain obligations under the TRIPS Agreement where the complaining member normally identifies them in its request, arbitrators and potential targets do not generally examine which “obligations” a retaliating member seeks authorization to suspend. See, e.g., *US – Gambling (Article 22.6 – US)*, *supra* note 92, ¶¶ 5.6-5.7; *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶ 173. A complaining member may request authorization from the DSB by simply stating that it intends to suspend the application of obligations under certain agreements. For instance, it could obtain authorization from the DSB to suspend unspecified obligations under the Agreement on Textiles and Clothing with respect to certain sectors. See *US – 1916 Act (EC) (Article 22.6 – US)*, *supra* note 130, ¶¶ 3.10-3.11. Thus, arbitrators accept requests and grant authorization to suspend unspecified obligations, while allowing the requesting member to decide which particular obligations it wishes to suspend when it implements retaliation. See *id.* ¶ 3.13. In this regard, it would be legitimate, if the obligations are rotated within the agreements authorized by the DSB.

³⁸² See Davey, *supra* note 369, at 368-369. Davey further argues that there would be no problem, if “the uncertainty associated with a plan to use a carousel is considered in the setting of the level of retaliation.” *Id.* Mavroidis suggests that a paragraph should be added in the DSU that, in case of unilateral modification, a retaliating member must bear the burden of proof that the modified level of retaliation does not exceed the level of nullification or impairment. See Petros C. Mavroidis, *Proposals for Reform of Article 22 of the*

In this regard, the Philippines and Thailand have proposed that a requesting member be allowed to submit a modified list of concessions to arbitrators for consideration of whether the level of such retaliation is equivalent to the level of nullification or impairment any time after authorization has been given by the DSB.³⁸³ The general intent of their proposal is to ensure that the standard of equivalence is respected by requiring a detailed list of products that a requesting member intends to suspend, and to prevent the suspension of concessions or other obligations other than those contained in the retaliation list considered by the arbitrators.³⁸⁴

Overall, as long as the modified retaliation respects the standard of equivalence, the rotation of a retaliation list or the suspension of any obligations within the agreements authorized by the DSB would be legitimate. Such changes in the implementation method would create strong incentives for compliance.

2.2. Providing Gradual Changes of the Level of Retaliation

DSU: *Reconsidering the “Sequencing” Issue and Suspension of Concessions*, in *The WTO Dispute Settlement System 1995-2003* 71 (Federico Ortino & Ernest-Ulrich Petersmann eds., 2004).

³⁸³ See Special Session of the Dispute Settlement Body, *Proposal to Review Article 22.7 of the Understanding on Rules and Procedures Governing the Settlement of Disputes*, Communication from the Philippines and Thailand, ¶ (g), TN/DS/W/3 (Mar. 21, 2002) [hereinafter Article 22.7 Proposal]. See also World Trade Organization, Ministerial Conference, *Fourth Session, Proposal to Amend the Dispute Settlement Understanding on Rules and Procedures Governing the Settlement of Disputes*, Communication from the Philippines and Thailand, WT/MIN(01)/W/3 (Oct. 9, 2002).

³⁸⁴ See Article 22.7 Proposal, *supra* note 383, ¶ (C) & ¶ (f). In this context, the arbitrators in *EC – Hormones (US)* (Article 22.6 – EC) states that:

The more precise a request for suspension is in terms of product coverage, type and degree of suspension, etc..., the better. Such precision can only be encouraged in pursuit of the DSU objectives of “providing security and predictability to the multilateral trading system” (Article 3.2) and seeking prompt and positive solutions to disputes (Articles 3.3 and 3.7). It would also be welcome in light of the statement in Article 3.10 that “all Members will engage in [DSU] procedures in good faith in an effort to resolve the dispute.”

EC – Hormones (US) (Article 22.6 – EC), *supra* note 129, ¶ 16 n.16. Moreover, the arbitrators in *US – Offset Act (Byrd Amendment) (Canada)* (Article 22.6 – US) urged the requesting member “to provide a more detailed request to ensure greater transparency and predictability in its suspensions” so as to “alleviate concerns that, once authorized, the level of suspension of obligations may exceed the level of nullification or impairment.” *US – Offset Act (Byrd Amendment) (Canada)* (Article 22.6 – US), *supra* note 230, ¶ 2.33 & ¶ 2.33 n.34.

The gradual change of the level of retaliation over time could be considered as an additional method of promoting implementation. As Shaffer and Ganin argued, “incremental or partial” retaliation rather than the full amount of retaliation would create more incentives for compliance.³⁸⁵

The main advantage of adopting incremental or partial retaliation seems to be that such retaliation would lessen the negative impact on importers and consumers in the retaliating member, while maintaining sufficient pressure on the exporters in the violating member to lobby their government for compliance. They become “irritants without however blocking trade flows entirely.”³⁸⁶ In this regard, compliance can be achieved by retaliation in small amounts and by less prohibitive means. Moreover, such changes would be more powerful in the sense that frustrated exporters are in a better position to lobby their government than exporters who have entirely lost their markets without any hope for reclaiming it.³⁸⁷ In addition, they would inculcate the perception in the violating member that retaliation is not merely an alternative to compliance.³⁸⁸

In *US – Offset Act (Byrd Amendment)*, a partial amount of retaliation was implemented by the EC in the form of 15 per cent additional duty, which the Commission adjusted each year in order to ensure the level of equivalence between the retaliation imposed and the latest annual disbursement under the Byrd Amendment.³⁸⁹ In *US – FSC*, the EC increased the level of retaliation over time instead of initially implementing the full amount of retaliation. Retaliation was applied in the form of an additional 5 per cent import duty, which was increased by 1 per cent every month for a period of one year, or

³⁸⁵ See Shaffer & Ganin, *supra* note 339, at 75.

³⁸⁶ Ehring, *supra* note 346, at 256.

³⁸⁷ See *id.* at 256.

³⁸⁸ See Davey, *supra* note 222, at 17.

³⁸⁹ See Esther Lam, *Japan to Continue Imposing WTO Sanctions on U.S. for not Complying with Byrd Ruling*, 23 Int’l Trade Rep. (BNA) 1292 (Sept. 7, 2006).

until the duty level reached 17 per cent. This ultimately resulted in the US repealing the FSC regime in a WTO-consistent manner, even though the total amount of retaliation was not applied.³⁹⁰

Overall, as long as the gradual change of the level of retaliation, in the form of incremental or partial implementation, meets the standard of equivalence, there would be no problem for a retaliating member to use it. Combining the rotation of products on a retaliation list with the gradual change of the level of retaliation would create strong incentives for compliance.

3. Introducing Collective Retaliation

Because the effectiveness of retaliation is based on a member's economic power, retaliation by a relatively small country member will not likely have a great impact on a large country member. Arbitrators have observed that, as a practical matter, obtaining the purpose of inducing compliance may be extremely difficult in cases where there is a great imbalance in terms of trade volume and economic power between the parties to a dispute.³⁹¹

While retaliation seems to work well when threatened by a developed country against a developing country or when threatened by one developed country against another, it may not be sufficient or effective for a developing country to attempt to use retaliation to force a developed country into compliance with WTO obligations. Therefore, the imbalance in compliance enforcement capacity constrains the ability of developing countries to exercise their right of retaliation.

³⁹⁰ See Kurt Ritterpusch & Gary G. Yerkey, *Conferees Reach Reconciliation Accord, Strip Some FSC Benefits to Offset Cost*, 23 Int'l Trade Rep. (BNA) 720 (May 11, 2006).

³⁹¹ See, e.g., *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶¶ 125-126.

In this regard, a number of scholars have proposed the concept of collective retaliation as a means to provide developing country members with a means to ensure better enforcement.³⁹² They argue that, while bilateral retaliation cannot deter non-compliance in disputes where there is an imbalance of power between members, collective retaliation would provide an effective means for small country members to bring their claims to the WTO dispute settlement system and have a formidable impact to exert pressures on large country members to comply with WTO rulings.³⁹³

The idea of collective retaliation was first raised in GATT in 1965, when a number of developing countries, Brazil and Uruguay, claimed that they lacked the ability to enforce compliance against developed countries.³⁹⁴ Recently, this issue has been raised a number of times in the WTO. The African Group and the Least Developed Countries (LDC) Group have proposed that all developing members be authorized to “collectively suspend concessions to a developed member,” notwithstanding the normal requirement of equivalence, on the basis of special and differential treatment.³⁹⁵

³⁹² Abbott recommended that a multilateral suspension of concessions would be a “true community sanction.” See Kenneth W. Abbott, *GATT as a Public Institution: The Uruguay Round and Beyond*, 18 Brook. J. Int’l L. 31, 79 (1992). See also Rene Guilherme S. Medrado, *Renegotiating Remedies in the WTO: A Multilateral Approach*, 22 Wis. Int’l L.J. 323 (2004).

³⁹³ See generally Alan W. Wolff, *Remedy in WTO Dispute Settlement*, in *The WTO: Governance, Dispute Settlement & Developing Countries* 783, 811 (Merit E. Janow, Victoria Donaldson & Alan Yanovich eds., 2008) (Arguing that collective retaliation would offer developing countries a better enforcement ability); Alavi, *supra* note 227, at 34 (Arguing that collective retaliation would be an option to be implemented by amending the DSU or applying a special and differential treatment provision); Pauwelyn, *supra* note 228, at 345 n.59 (Arguing that collective retaliation could be considered as “appropriate to the circumstances” under Article 21.7 of the DSU); Giovanni Maggi, *The Role of Multilateral Institutions in International Trade Cooperation*, 89 Am. Econ. Rev. 190, 190 (1999) (Approaching the concept of collective retaliation from a multilateral prisoners’ dilemma framework of three states).

³⁹⁴ See Committee on Trade and Development Ad Hoc Group on Legal Amendments to the General Agreement, *Proposal Submitted by the Brazilian and Uruguayan Delegations, Draft Decision on Article XXIII*, ¶ 12, COM.TD/F/W/4 (Oct. 11, 1965) [hereinafter Brazilian & Uruguayan Proposal].

³⁹⁵ For the proposal by the African Group, see Special Session of the Dispute Settlement Body, *Negotiations on the Dispute Settlement Understanding, Proposal by the African Group*, TN/DS/W/15 (Sept. 25, 2002) [hereinafter African Group Proposal]; Special Session of the Dispute Settlement Body, *Text for the African Group Proposals on Dispute Settlement Understanding Negotiations, Communication from Kenya*, TN/DS/W/42 (Jan. 24, 2003) [hereinafter African Group Text]. For the proposal by the LDC Group,

In assessing these proposals, however, there are a number of practical problems in implementing collective retaliation. First, if the standard of equivalence were to be respected, how could the collective level be allocated to other WTO members? If the standard of equivalence were to be disregarded, collective retaliation could be punitive, which would contradict the very nature and purpose of WTO retaliation.

Second, it is questionable whether members not affected by the violation would be willing to share the cost of implementing retaliation. Since implementing retaliation hurts them and aggravates trading relations with the complained-against member, they may feel uncomfortable supporting retaliation efforts.³⁹⁶

Third, and most importantly, non-party members to the dispute would have no incentives to implement retaliation in a way that induces the violating member to comply with WTO rulings. With bilateral retaliation, an injured member generally administers retaliation that is most likely to exert pressures on politically powerful exporters so as to cause them to lobby their government to withdraw its WTO-inconsistent measure. On the other hand, with collective retaliation, non-party members who are not affected by the violation would probably administer retaliation that is most likely to benefit their protectionist groups.³⁹⁷ This strategy would have nothing to do with the purpose of inducing compliance. Rather, it could increase the global trade barriers, leading to the adoption of more protectionist policies.³⁹⁸

Thus, although collective retaliation seems to offer an effective way for a small country member to stand against a large country member, these practical aspects make its

see Special Session of the Dispute Settlement Body, *Negotiations on the Dispute Settlement Understanding, Proposal by the LDC Group*, TN/DS/W/17 (Oct. 9, 2002) [hereinafter LDC Group Proposal].

³⁹⁶ See McGivern, *supra* note 33, at 156.

³⁹⁷ See Jide Nzelibe, *The Case against Reforming the WTO Enforcement Mechanism*, 2008 U. Ill. L. Rev. 319, 321-322 (2008).

³⁹⁸ See *id.* at 333-339.

use problematic. In political reality, none of the members would be willing to participate in collective retaliation in order to settle unrelated trade disputes.³⁹⁹

However, there is a possibility to incorporate collective retaliation in limited circumstances. As long as the standard of equivalence is maintained, multiple complainants in the same dispute may collectively retaliate against the violating member, i.e., five complainants in *EC – Bananas*: Ecuador, Guatemala, Honduras, Mexico, and the US. More specifically, instead of implementing retaliation individually based on each authorized amount, parties to collective retaliation could coordinate their efforts and take proportional shares in the total level of retaliation corresponding to their retaliation capacity. For instance, the US might take some portion of Honduras' and Guatemala's authorized level of retaliation and, thus, retaliate more than the initially authorized amount.

This strategy would not only indirectly provide small country complainants with

³⁹⁹ In the same vein, Mexico has proposed that a complaining member should be allowed to negotiate its right to retaliate against a violating member with a third member in exchange of a mutually agreed benefit, which may even take the form of cash. See Mexican Proposal, *supra* note 366, at 5. In Mexico's view, negotiable retaliation is an economic concept that would create incentives for compliance since a third member would have more realistic power to retaliate. Moreover, it would ensure better readjustment of concessions since the complaining member would receive a tangible benefit in exchange of its right to retaliate. *Id.* at 6. Under proposed Article 22.7 *bis* of the DSU, both the complaining member and the third member shall jointly request the DSB to authorize retaliation by the third member. Any transfer shall not exceed the level of suspension authorized by the DSB. See Mexican Text, *supra* note 366. Bagwell, Mavroidis, and Staiger have pointed out that this strategy would provide developing country members an efficient use of WTO remedies and efficiently allocate to the member who values such a right the most. See Kyle Bagwell, Petros C. Mavroidis & Robert W. Staiger, *Auctioning Countermeasures in the WTO*, 73 J. Int'l Econ. 309 (2007); Kyle Bagwell, Petros C. Mavroidis & Robert W. Staiger, *The Case for Tradable Remedies in WTO Dispute Settlement*, in Economic Development and Multilateral Trade Cooperation 395 (Simon J. Evenett & Bernard M. Hoekman eds., 2006). See also Mateo Diego-Fernandez & Roberto Rios Herran, *The Reform of the WTO Dispute Settlement Understanding: A Closer Look at the Mexican Proposal*, 1 Manchester J. Int'l Econ. L. 4 (2004). However, one can seriously wonder why a third member would be willing to purchase the right of retaliation and implement it on behalf of someone else. Moreover, as Poland argued, negotiable retaliation would discourage members from negotiating seriously to find mutually agreed solutions to their disputes, which was also one of the objectives of the dispute settlement system. See TN/DS/M/6, *supra* note 367, ¶ 52. And, again, only protectionist groups in the third member would be interested in lobbying for the purchase of the right of retaliation. Thus, the efficacy of retaliation in inducing the violating member to comply would be undermined. See Nzelibe, *supra* note 397, at 335.

effective retaliation but would also create more opportunities to inflict sufficient harm on the most politically powerful exporters in the violating member to lobby their government for compliance.

4. Renewing TRIPS Retaliation

Along with the introduction of collective retaliation among multiple complainants in the same dispute, retaliation by suspending TRIPS obligations could also be considered as a strong tool to solve the problem of imbalance in the compliance enforcement capacity and to provide sufficient pressure on the violating member for compliance.

Many developing members have proposed unconditional cross-retaliation, since they view the conditions enumerated under Article 22.3 of the DSU for cross-retaliation as being too cumbersome. They proposed to insert a new paragraph, Article 22.3*bis*, stating that in disputes where a complaining member is a developing member and a complained-against member is a developed member, the complainant shall have the right to seek authorization for retaliation “with respect to any or all sectors under any covered agreements.”⁴⁰⁰ Hence, it would be unnecessary to state reasons why retaliation in the same sector or under the same agreement is not practicable or effective and why the circumstances are serious enough to request the authorization of cross-retaliation.⁴⁰¹

Considering the negative and disproportionate effects of tariff retaliation on its own economy, retaliation by suspension of TRIPS obligations is of significant value for a developing member in a dispute with a developed member because intellectual property

⁴⁰⁰ See Developing Countries’ Proposal, *supra* note 223; Special Session of the Dispute Settlement Body, *Dispute Settlement Understanding Proposal: Legal Text, Communication from India on behalf of Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia*, TN/DS/W/47 (Feb. 11, 2003).

⁴⁰¹ See Werner Zdouc, *Cross-retaliation and Suspension under the GATS and TRIPS Agreements*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 515, 522-523 (Chad P. Bown & Joost Pauwelyn eds., 2010).

protection generally tends to serve the interests of developed members.⁴⁰² There is a high demand for protection of intellectual property rights in developed members, and such retaliation would not easily be endured by those industries which rely on the protection of intellectual property rights. As such, they would likely apply considerable political pressure for compliance on their government.

In this sub-Section, I will examine the effectiveness of expanding the use of cross-retaliation on TRIPS obligations and the practical considerations associated with this proposal.

4.1. Effectiveness of TRIPS Retaliation

The critical issue is whether implementing TRIPS retaliation would work significantly better than tariff retaliation in inducing compliance by developed country members.

There are a number of reasons that TRIPS retaliation is preferable to tariff retaliation in terms of its effectiveness. First, with tariff retaliation, the economic harm to manufacturers, service providers and consumers in the retaliating member will often outweigh the economic harm inflicted on the complained-against member.⁴⁰³ On the contrary, TRIPS retaliation reduces the payment outflows for intellectual property rights during its implementation without inflicting harm on local manufacturers and consumers. Thus, from an economic standpoint, it is more desirable in that it does not generate the adverse impacts which result from raising tariff barriers or restricting services.⁴⁰⁴

⁴⁰² See Nottage, *supra* note 229, at 335-336; Arvind Subramanian & Jayashree Watal, *Can TRIPS Serve as an Enforcement Device for Developing Countries in the WTO*, 3 J. Int'l Econ. L. 403, 406 (2000).

⁴⁰³ See *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶¶ 94-96.

⁴⁰⁴ See Frederick M. Abbott, *Cross-Retaliation in TRIPS: Options for Developing Countries* 11-12 (Int'l

Second, there may be situations where the market of a developing member is so small that retaliation under GATT or GATS commitments would not have a significant impact on the economy of the developed member.⁴⁰⁵ In *US – Gambling (Article 22.6 – US)*, the arbitrators agreed with Antigua that, given the low level of imports in the service sectors, such as transportation, travel and insurance services, it would have virtually no impact upon the US in implementing retaliatory measures on these sectors.⁴⁰⁶ However, intellectual property rights protected under the TRIPS Agreement are generally important assets in most developed members. Effective protection of intellectual property rights is one of their essential concerns. The TRIPS Agreement confers enormous benefits to information technology industries, pharmaceutical industries, owners of trademarks and industrial designs, patent holders, film and music companies. These various intellectual property owners from developed members also comprise their most powerful political constituencies.⁴⁰⁷ If a retaliating member targets these industries and aims to suspend their TRIPS benefits, these industries will have sufficient political power to lobby their government for compliance.⁴⁰⁸ Thus, TRIPS retaliation can be expected to have a

Ctr. for Trade & Sust. Dev. Programme on Dispute Settlement and Legal Aspects of International Trade, Issue Paper No. 8, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1415802. See also Thomas Cottier, *The Prospects for Intellectual Property in GATT*, 28 Common Mkt. L. Rev. 382 (1991). As seen in *US – Gambling (Article 22.6 – US)*, retaliation in the services sector potentially would also have an adverse impact on the consumers of the retaliating member, since they have to pay more for services. See *US – Gambling (Article 22.6 – US)*, *supra* note 92, ¶ 4.49. See also Frederick M. Abbott, *Cross-retaliation in TRIPS: Issues of Law and Practice*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 536, 547 (Chad P. Bown & Joost Pauwelyn eds., 2010) [hereinafter Abbott 2010]; Zdouc, *supra* note 401, at 521. For a general explanation on retaliation under GATS commitments, see Arthur E. Appleton, *Preliminary Thoughts on WTO retaliation in the Services Sector*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 589 (Chad P. Bown & Joost Pauwelyn eds., 2010).

⁴⁰⁵ See Abbott 2010, *supra* note 404, at 545 & 547.

⁴⁰⁶ See *US – Gambling (Article 22.6 – US)*, *supra* note 92, ¶ 4.94.

⁴⁰⁷ See Subramanian & Watal, *supra* note 402, at 406.

⁴⁰⁸ See Henning Grosse Ruse-Khan, *Suspending IP Obligations under TRIPS: A Viable Alternative to Enforce Prevailing WTO Rulings?* 2 (Ctr. for Int'l Envtl. L. WTO Dispute Settlement System Pol'y Paper, 2008), available at http://www.ciel.org/Publications/TRIPS_IP_7May08.pdf. See also Shamnad Basheer, *Turning Trips on Its Head: An "IP Cross Retaliation" Model for Developing Countries*, 3 Law & Dev. Rev.

significant impact on the economy of the violating member, which may generate strong incentives for compliance.

Third, TRIPS retaliation could increase the bargaining position of a developing member against a developed member.⁴⁰⁹ In *EC – Bananas*, when Ecuador threatened to retaliate on TRIPS obligations, it entered into a successful negotiation with the EC.⁴¹⁰

Lastly, TRIPS retaliation could be welfare-enhancing if implemented strategically since it “facilitates technological development and domestic innovation through imitation and technological learning.”⁴¹¹ It is better for the retaliating member in the sense that it reduces prices, while simultaneously increasing the availability of those products in its market.

Overall, TRIPS retaliation offers a strong compliance enforcement tool for developing members in disputes against large developed members. It does not create an adverse impact on the member implementing retaliation but generates economic benefits and encourages strong TRIPS-connected lobbies in the targeted member to exert considerable political pressure on their government for compliance.

4.2. Practical Considerations of TRIPS Retaliation

139, 154-155 (2010); Zdouc, *supra* note 401, at 525. Typically, members have proposed to target copyrighted works or patented products protected under the TRIPS Agreement.

⁴⁰⁹ See Basheer, *supra* note 408, at 155. See also Thomas Cottier, *Intellectual Property in International Trade Law and Policy: The GATT Connection*, 48 *Aussenwirtschaft* 79 (1992).

⁴¹⁰ See James McCall Smith, *Compliance Bargaining in the WTO: Ecuador and the Bananas Dispute*, in *Negotiating Trade: Developing Countries in the WTO and NAFTA* 257, 268-273 (John S. Odell ed., 2006).

⁴¹¹ Ruse-Khan, *supra* note 408, at 1. Ruse-Khan opines that “suspending the constraints in Art.30 and 31 of TRIPS on patent exceptions and compulsory licenses could be used to enable access to and (experimental) use of patented technology in a way which facilitates the development of value added products, other follow-on innovations or merely the process of technological learning.” *Id.* at 3. See also Henning Grosse Ruse-Khan, *A Pirate of the Caribbean? The Attractions of Suspending TRIPS Obligations*, 11 *J. Int’l Econ. L.* 313, 354 (2008) (Arguing that “suspending patents for HIV/AIDS medication . . . could export the medicine to least developed countries where most of these drugs generally are not under patent”) [hereinafter Ruse-Khan 2008].

Apart from the effectiveness of TRIPS retaliation, there are a number of practical considerations in its implementation.

First, intellectual property rights are rights acquired by private individuals and are widely protected under domestic legislation. In this regard, TRIPS retaliation may undermine private rights protected under domestic law and even be challenged by private individuals in their respective domestic courts as being illegal.⁴¹² In this vein, the arbitrators in *EC – Bananas (Ecuador) (Article 22.6 – EC)* raised a concern that the implementation of TRIPS retaliation may “give rise to legal difficulties or conflicts within the domestic legal system of the Member so authorized (and perhaps even of the Member(s) affected by such suspension).”⁴¹³ To the extent that such difficulties or conflicts may exist, it may be difficult to implement TRIPS retaliation.

Thus, an effective use of TRIPS retaliation would require a retaliating member to establish a domestic legal system that allows its implementation. In particular, domestic legislation should specify that intellectual property rights may be suspended in cases where the member obtains the authorization to implement TRIPS retaliation from the DSB.⁴¹⁴

Recently, Brazil considered establishing a legislative scheme for TRIPS retaliation in order to avoid this problem. In 2008, the bill, PL 1893/2007, which allows derogation from the domestic intellectual property legal framework and simplifies the procedure for the implementation of TRIPS retaliation, was approved by the Commission on Economic Development of the Chamber of Deputies.⁴¹⁵ In addition, with regard to *US – Upland*

⁴¹² See Zdouc, *supra* note 401, at 527; Subramanian & Watal, *supra* note 402, at 415.

⁴¹³ *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶ 158.

⁴¹⁴ See Subramanian & Watal, *supra* note 402, at 411.

⁴¹⁵ See Luiz Eduardo Salles, *Procedures for the Design and Implementation of Trade Retaliation in Brazil*,

Cotton, the Brazilian government issued a decree in February 2010 which authorizes the use of TRIPS retaliation against the US.⁴¹⁶ The decree seems to speed up the implementation process, which could ultimately induce effective compliance.

Second, intellectual property rights subject to TRIPS retaliation may also be protected under other international agreements. Thus, the possibility of conflict always exists when these rights are to be suspended by TRIPS retaliation. For example, if Antigua in *US – Gambling* allows US copyrighted products to be posted on websites for downloads, it may conflict with the exclusive right of reproduction under the Berne Convention for the Protection of Literary and Artistic Works, which Antigua is a signatory of.

Article 2.2 of the TRIPS Agreement reads that “[n]othing in Parts I to IV of this Agreement shall derogate from existing obligations that Members may have to each other under the Paris Convention, the Berne Convention, the Rome Convention and the Treaty on Intellectual Property in Respect of Integrated Circuits.” With regard to this Article, however, the arbitrators in *EC – Bananas (Ecuador)* (Article 22.6 – EC) observed that:

Article 2.2 only refers to Parts I to IV of the TRIPS Agreement, while the provisions on “Dispute Prevention and Settlement” are embodied in Part V. This Part of the TRIPS Agreement contains, *inter alia*, Article 64.1 which provides that the DSU applies to disputes under the TRIPS Agreement unless otherwise specifically provided therein However, nothing in Article 64

in The Law, Economics and Politics of Retaliation in WTO Dispute Settlement 297, 302-305 (Chad P. Bown & Joost Pauwelyn eds., 2010). The bill 1893/07, PL-1893 (“P.L meaning project of law, i.e., projeto de lei, in literal version”) was submitted on August 28, 2007. The author is Representative Paulo Teixeira (national party: PT, from Sao Paulo). The last move that appears is of March 26, 2009, when the project was sent to the Committee on Foreign Relations and National Defense (Credner). The Appointed Rapporteur is Representative Antonio Carlos Mendes Thame (national party: PSDB, from Sao Paulo) and the Committee on Foreign Relations and National Defense (Credner) closed the deadline for amendments to the bill in April 2009. No amendments were tabled. So far, there is no evidence that this bill has been approved and turned into law, as last checked in January 22, 2011, according to the websites of Brazilian Senate and Brazilian Congress: www.senado.gov.br and www2.camara.gov.br, respectively.

⁴¹⁶ The decree covers “a wide range of options including ignoring foreign patents, reducing the validity of domestic patents, delaying the approval of brand licensing requests, and suspending remittances for the payment of royalties.” See Taylor, 102 US Products, *supra* note 355.

or other Articles of the TRIPS Agreement provides specifically that Article 22 of the DSU does not apply to the TRIPS Agreement.⁴¹⁷

They further observed that Articles 22.3 (f)(iii) and (g)(iii) of the DSU clearly specify that Sections of the TRIPS Agreement are “sectors,” and that the TRIPS Agreement is an “agreement,” in respect of which the suspension of TRIPS obligations may be sought, pursuant to Article 22.3 (b) and (c), by a complaining member and authorized by the DSB. And, if the requesting member has fulfilled all the requirements of Article 22 to implement TRIPS retaliation, “neither Article 2.2 read in context with Article 64 of the TRIPS Agreement, nor any other provision of the WTO agreements indicate that an authorization by the DSB of that request would in theory be prohibited under WTO law.”⁴¹⁸ They also added that it was not within their jurisdiction to determine whether a WTO member implementing authorized TRIPS retaliation measures would “act inconsistently with its international obligations arising from treaties other than the agreements covered by the WTO.”⁴¹⁹

Moreover, retaliation under TRIPS would be precluded from being wrongful under public international law even if it breached another international agreement, as long as it was taken in response to a violating member’s WTO-inconsistent measures. Article 22 of the ILC Draft provides that “[t]he wrongfulness of an act of a State not in conformity with an international obligation towards another State is precluded if and to the extent that the act constitutes a countermeasure taken against the latter state in accordance with [the conditions set out in Articles 49 to 54].” The implementation of TRIPS retaliation

⁴¹⁷ *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶ 150.

⁴¹⁸ *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶ 151.

⁴¹⁹ *Id.* ¶ 152. Subramanian and Watal argue that “this conflict would, under customary rules of interpretation of international law as laid out in the 1969 Vienna Convention on the Law of Treaties, have to be decided in favor of TRIPS, which is the later treaty.” Subramanian & Watal, *supra* note 402, at 411.

seems to satisfy these conditions, since it is directed against a member who is maintaining a WTO-inconsistent measure,⁴²⁰ it is a temporary measure until compliance has been achieved,⁴²¹ and it does not involve any departure from fundamental obligations including peremptory norms of public international law.⁴²² And its level is equivalent to the level of nullification or impairment, which reflects the principle of proportionality under Article 51.⁴²³

4.3. Implementation of TRIPS Retaliation

In the event of TRIPS retaliation, TRIPS obligations are suspended for the retaliating member during the time of non-compliance. Here, the existence and scope of TRIPS retaliation is restricted to the territory of the retaliating member. In other words, it is only extended to intellectual property rights that are protected under the domestic law and exploited in the domestic market of the retaliating member.⁴²⁴

In this regard, a retaliating member cannot trade products violating TRIPS requirements with any other WTO member. The arbitrators in *EC – Bananas (Ecuador)* (Article 22.6 – EC) stated that an authorization of TRIPS retaliation does not exonerate any other WTO member from any of its obligations under the TRIPS Agreement. Thus, other members are under an obligation to enforce Article 51 of the TRIPS Agreement on special border measures in order to prevent the importation of products violating TRIPS

⁴²⁰ See ILC Draft art. 49.1. The International Court of Justice clearly stated that in order for a countermeasure to be justifiable, it must be “taken in response to a previous international wrongful act of another State and . . . directed against the State.” *Gabcikovo-Nagymaros Project* (Hung. v. Slov.), 1997 I.C.J. 7, at 55 (Sept. 25).

⁴²¹ See ILC Draft art. 49.2.

⁴²² See ILC Draft art. 50.1.

⁴²³ In practice, since there are no enforcement measures under other international agreements dealing intellectual property rights, there may be no practical legal consequence for violating these agreements.

⁴²⁴ See Ruse-Khan 2008, *supra* note 411, at 348-349.

requirements, even if the violation is permitted in the retaliating member state.⁴²⁵

The question then becomes how the retaliating member can guarantee that products are sold only in the domestic market and not exported to other members. This is an important issue because, if those products are exported to other members, there may be a possibility of excessive retaliation.

In *US – Gambling*, Antigua at first considered posting US copyrighted products for downloading online as an option for retaliation.⁴²⁶ However, considering the worldwide availability of these products through the Internet, there were no means to limit them to users located only within the territory of Antigua. Thus, the existence and scope of retaliation in a form such as this may not only expand beyond the territory of the retaliating member but also exceed the level of nullification or impairment.⁴²⁷

In contrast, if the products were strictly controlled or supervised at the member level, i.e., the government exercises the exclusive right on those products for the time of suspension, it would be easier to prevent exportation to other members and limit the potential for excessive retaliation. This was the case in *EC – Bananas (Ecuador) (Article 22.6 – EC)*, where Ecuador considered “installing a system whereby companies or individuals established in Ecuador could obtain an authorization from the Ecuadorian government to [implement retaliation] . . . within the Ecuadorian territory.”⁴²⁸ This authorization was to be awarded through a “licensing system” which would limit retaliation “in terms of quantity, value and time . . . [reserving the government’s] right to

⁴²⁵ See *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶¶ 153-156. See also *US – Gambling (Article 22.6 – US)*, *supra* note 92, ¶ 5.11.

⁴²⁶ See Daniel Pruzin, *Group Argues IP Retaliation Feasible in WTO Disputes against U.S. Measures*, 25 Int’l Trade Rep. (BNA) 746 (May 22, 2008).

⁴²⁷ See Ruse-Khan, *supra* note 411, at 358.

⁴²⁸ *EC – Bananas (Ecuador) (Article 22.6 – EC)*, *supra* note 92, ¶ 161.

revoke these licences at any time.”⁴²⁹ The arbitrators were in favor of Ecuador’s intention to exercise control over the distribution of rights rather than adopting a suspension of all the related rights.⁴³⁰ Overall, so as to ensure the authorized level of retaliation, it would be important to install a government-controlled system that would ensure that the products violating TRIPS requirements were only to be sold in the domestic market.

In addition, as argued in the previous sub-Section, TRIPS retaliation in a collective manner should be carefully considered. Since a sufficient domestic market and consumer demand are required for TRIPS retaliation in order to impose a significant impact on the violating member, small developing members as sole complainants often lack the markets or demand for intellectual property to effectively utilize retaliation as a remedy. Thus, in cases where there are multiple complainants that all have been authorized and have fulfilled the requirement of Article 22.3 for TRIPS retaliation, they could freely trade products violating TRIPS requirements from the violating member among themselves.⁴³¹ This collective enforcement strategy would particularly be effective, for example, in the public health perspective in the case in which one of the complainants manufactures patented pharmaceuticals that could then be exported to all other complaining members at a cheaper rate where a manufacturing capacity is insufficient.⁴³²

In sum, a request to cross-retaliate through the suspension of TRIPS obligations has been a huge development in WTO dispute settlement remedies, especially for developing members in disputes against developed members. TRIPS retaliation encourages strong

⁴²⁹ *Id.*

⁴³⁰ *See id.* ¶¶ 159-164.

⁴³¹ *See* Ruse-Khan 2008, *supra* note 411, at 361-362.

⁴³² *See* Ruse-Khan, *supra* note 408, at 7.

TRIPS-connected lobbies in developed members where there is a high demand for protection of intellectual property rights to put considerable political pressure on the government for compliance. In this regard, it is important to promote its use.

5. Introducing Monetary Payment

Considering the negative and disproportionate effects of retaliation on the country using it, monetary payment could be seriously considered in lieu of retaliation. It would often be more beneficial for developing members to receive a monetary payment rather than to implement retaliation.

An introduction of monetary payments would generally provide more options to the complaining member that may feel uncomfortable with implementing retaliation. As Gray opined with respect to state responsibility under public international law, “the determination of the consequences of a breach of international law is left initially to the discretion of the injured state.”⁴³³ Hence, more options for remedies for the complaining member would provide more opportunities to encourage the violating member to achieve compliance and, ultimately, build the stability and security of the WTO dispute settlement system.

In this sub-Section, I will examine the effectiveness of and practical considerations related to monetary payments and suggest how they could be implemented.

5.1. Effectiveness of Monetary Payment

The remedy of monetary payment is not a novel idea in international trade disputes. It was first raised in 1964 when Brazil and Uruguay proposed an amendment of Article

⁴³³ Christine D. Gray, *Judicial Remedies in International Law* 6 (1987).

XXIII of GATT.⁴³⁴ Their proposal was intended to provide monetary compensation as an additional remedy for developing countries in disputes against developed countries, where an illegal trade measure seriously impaired the trade capacity of developing countries. It has been also proposed quite a number of times in the WTO in connection with Doha Round negotiations. Pakistan first proposed to clarify that the term “compensation” used in Article 22 includes monetary compensation.⁴³⁵ The African Group also proposed “mandatory” monetary compensation to be made until the withdrawal of the measure in breach of WTO obligations.⁴³⁶ Later, the LDC Group proposed that monetary compensation should be equal to the injury suffered, i.e., injury “directly arising from the offending measure or foreseeable under the offending measure.”⁴³⁷

There are a number of reasons why monetary payment could be preferable to retaliation. First, monetary payment is not trade-restrictive, while retaliation increases restrictions on trade by adding more trade barriers.⁴³⁸ Thus, monetary payment does not undermine the free trade principle of the WTO.

Second, there may be a possibility of direct compensation to the private entities that are injured by WTO violations. On the one hand, the violating member may collect funds from the beneficiaries of the violation. In any event, the wronged member could use such

⁴³⁴ It reads that “[i]f the measures complained of have been applied by a contracting party recognized as a developed country, the organ of arbitration may recommend, in particular suitable financial compensation.” Report of the Committee, *Committee on the Legal and Institutional Framework of GATT in Relation to Less-Developed Countries*, Annex 4, L/2195/Rev.1 (Apr. 13, 1964). See also Brazilian & Uruguayan Proposal, *supra* note 394, ¶ 7.

⁴³⁵ See General Council, *Preparations for the 1999 Ministerial Conference: The Dispute Settlement Understanding (DSU)*, Communication from Pakistan, WT/GC/W/162 (Apr. 1, 1999).

⁴³⁶ See African Group Proposal, *supra* note 395, ¶ 5. See also African Group Text, *supra* note 395.

⁴³⁷ See LDC Group Proposal, *supra* note 395, ¶ 13.

⁴³⁸ See Rebecca Ullman, *Enhancing the WTO Tool Kit: The Case for Financial Compensation*, 9 Rich. J. Global L. & Bus. 167, 182-183 (2010).

payments to compensate those injured by the WTO-inconsistent measure.⁴³⁹ In this regard, monetary payments could be analogized to reparation, which is different from retaliation, where burdens are imposed on sectors unrelated to a dispute.⁴⁴⁰

Third, monetary payment does not impose any burden on consumers and industries of the complaining member as is often the case with retaliation. In this sense, monetary payment does not hurt “innocent bystanders” that are unrelated to the dispute.⁴⁴¹ From an economic standpoint, it would be better for the complaining member to receive monetary payment rather than to implement retaliation.

5.2. Practical Considerations of Monetary Payment

Apart from its desirability, there are a number of practical considerations in providing monetary payment. First, perhaps the most critical point of monetary payment is whether it is significantly better than retaliation in terms of inducing compliance. In general, retaliation can be expected to have a significant impact on the economy of a violating member creating sufficient political pressure on the government for compliance. By comparison, monetary payment is just a payment that is simply paid out of the general revenue of a government. It does not create the political pressure that retaliation does in

⁴³⁹ See Davies, *supra* note 210, at 40; Choi, *supra* note 364, at 1065.

⁴⁴⁰ However, since only member states are eligible to claim under the DSU, it is not clear whether the injured private actors will properly be compensated. In other words, there may be no incentive for the complaining member to use monetary payment to benefit the private actors that were initially injured by the inconsistent measure. See Nzelibe, *supra* note 397, at 322. Thus, the problem of redistribution of monetary payment received would exist. However, it is in the discretion of the government to decide on how to allocate such payment to private actors, which is the authority of each member state to exercise its own sovereignty. See Marco Bronckers & Naboth van den Broek, *Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Settlement*, 8 J. Int'l Econ. L. 101, 110 n.25 & 116-117 (2005). See also Pei-kan Yang, *Some Thoughts on a Feasible Operation of Monetary Compensation as an Alternative to Current Remedies in the WTO Dispute Settlement*, 3 Asian J. WTO & Int'l Health L. & Pol'y 423, 445 (2008).

⁴⁴¹ See Bronckers & Broek, *supra* note 440, at 110; Broek, *supra* note 37, at 155.

order to induce compliance.⁴⁴² In this regard, it may be true that monetary payment would have a less compliance-inducing effect than retaliation.

However, as suggested in the previous sub-Section, if retroactive remedies can be introduced, they may generate strong incentives for compliance. In doing so, not only the past injuries can be redressed to some degree, but also the violating member can be deterred from delaying compliance.⁴⁴³ In addition, it rather seems to be fair that the amount would be paid out of the general revenue of a government because it is the government, and not private entities, that is acting inconsistently with WTO obligations. Accordingly, it may generate more incentives for compliance than retaliation in the sense that the government has to make payment for the violation itself rather than shifting the cost to private entities.⁴⁴⁴

Second, monetary payments may result in large members continuing their violation and simply paying compensation for a long period of time. In other words, they may create room for them to buy out their breach of WTO obligations with a certain amount of money. Choi has expressed concern that a large member, such as the US, which provides a large amount of money in international aid, could simply reduce aid so as to fund monetary payments. Moreover, he is concerned that there may be a possibility of two large members offsetting different monetary payments against each other, for example, between the non-compliance of the US in *US – FSC* and the non-compliance of

⁴⁴² See Nzelibe, *supra* note 232, at 251-252; Broek, *supra* note 37, at 156. Nzelibe argues that monetary payment does not create incentives for the government to ensure that the strong supporters of the original violation be punished and to directly compensate the groups that suffered from such a violation. See Nzelibe, *supra* note 397, at 323.

⁴⁴³ See Bronckers & Broek, *supra* note 440, at 110-111.

⁴⁴⁴ See Bryan Mercurio, *Why Compensation Cannot Replace Trade Retaliation in the WTO Dispute Settlement Understanding*, 8 World Trade Rev. 315, 329 (2009); Bronckers, *supra* note 360, at 62.

the EC in *EC – Hormones*.⁴⁴⁵

However, in any event, monetary payment will not be a substitute for the primary remedy, which is the withdrawal of the WTO-inconsistent measure. It is not a one-time payment. It would be due periodically as long as such measures are in place. The WTO Consultative Board opined that monetary payment is “only a temporary fallback approach pending full compliance, otherwise the ‘buy out’ problems will occur.”⁴⁴⁶ Overall, the violating member that has made monetary payment still has the legal obligation to bring its measure into conformity with WTO obligations. In addition, one should recall that the complaining member who has prevailed in a case would not automatically receive a monetary payment. It is an alternative remedy for a failure to comply within a reasonable period of time. Thus, as long as compliance is achieved within such a period, there would be no requirement of monetary payment.⁴⁴⁷

Third, while retaliation is implemented by a complaining member without requiring any consent of a violating member, such is not the case for monetary payment. In other words, it is up to the violating member whether to make monetary payment and it thereby has great control over procedure.⁴⁴⁸ Since there is no supra-national authority that can enforce such payment, the problem of enforceability always exists.

However, enforceability may be not the problem that it initially appears to be. One

⁴⁴⁵ See Choi, *supra* note 364, at 1066.

⁴⁴⁶ Peter Sutherland et al., The Future of the WTO: Addressing Institutional Challenges in the New Millennium ¶ 243 (2004), available at http://www.wto.org/English/thewto_e/10anniv_e/future_wto_e.pdf. See also Bronckers & Broek, *supra* note 440, at 118-119.

⁴⁴⁷ See Adebukola A Eleso, *WTO Dispute Settlement Remedies: Monetary Compensation as an Alternative for Developing Countries* 32 (Berkeley Elec. Press Legal Series, Paper No. 1378, 2006), available at <http://law.bepress.com/expresso/eps/1378>.

⁴⁴⁸ See Nuno Liarmo & Kamal Saggi, *Tariff Retaliation versus Financial Compensation in the Enforcement of International Trade Agreements* 2 (World Bank Pol’y Research Working Paper Series, Paper No. 3873, 2006), available at <http://ideas.repec.org/p/wbk/wbrwps/3873.html>. See also Anderson, *supra* note 209, at 126.

way to examine the enforceability is to examine whether members are willing to resolve their disputes through the WTO dispute settlement system. As Hudec considers, all WTO members are repeat players that appear as both complainants and defendants. He opines that:

In considering the various positions taken by WTO member countries on remedial issues, it may be helpful to remember that all WTO governments are repeat players in this game, and that they have more or less equally frequent roles as both complainants and defendants. Consequently, all WTO governments . . . must view remedial issues from both perspectives. The optimum legal system . . . [is the one] that will be most helpful in enforcing one's trade agreement rights as complainant, while at the same time preserving the desired degree of freedom to deal with adverse legal rulings against one's own behavior.⁴⁴⁹

In this regard, if the violating member is obliged to make monetary payment, it may not easily refuse to do so.

And, as experience shows, there are a number of international agreements that provide a remedy in the form of monetary payment. For instance, monetary fines can be imposed against the member state that fails to comply with the rulings of the European Court of Justice.⁴⁵⁰ In state-investor disputes, Article 1135 of the North American Free Trade Agreement (NAFTA) provides that a final award of an arbitral tribunal requires either the payment of monetary damages or restitution of property. The side agreement of NAFTA on environment also provides that if a party persistently fails to effectively enforce its environmental law, the panel may impose a monetary enforcement

⁴⁴⁹ Hudec, *supra* note 22, at 377.

⁴⁵⁰ See Consolidated Version of the Treaty on the Functioning of the European Union, art. 260 (2), May 9, 2008, 2008 O.J. (C 115) 47, 161.

assessment.⁴⁵¹ Furthermore, monetary payment has been introduced in recent FTAs concluded with the US. For example, a violating party may agree to pay an annual monetary assessment instead of having concessions suspended. If the parties are unable to agree on an amount, the amount of monetary assessment is set at 50 per cent of the level of nullification or impairment determined by the arbitration or the complaining party.⁴⁵² Hence, the introduction of monetary payment in FTAs suggests that parties are willing to make such payments. And, most convincingly, in one WTO dispute, *US – Copyright Act*, the US voluntarily made a monetary payment for temporary non-compliance with WTO obligations.

Moreover, practical solutions could be considered. As Davey suggests, monetary payment could be enforced through a domestic court under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards as most of WTO members are signatories to the Convention.⁴⁵³

In addition, another solution would be to require members to create government funds for the payment of settlement of WTO disputes. This would allow compensation to be paid without any need for legislative approval.⁴⁵⁴ For instance, in 2002, the US established separate funds for the payment by the USTR of the amount of the total or

⁴⁵¹ See The North American Agreement on Environmental Cooperation, U.S.-Can.-Mex., Annex 34, Sept. 14, 1993, 32 I.L.M. 1480 [hereinafter NAAEC].

⁴⁵² See, e.g., US-Chile FTA art. 22.15; US-Singapore FTA art. 20.6; US-Australia FTA art. 21.11; US-Morocco FTA, art. 20.11. Substituting retaliation for monetary fines in violations of environmental and labor rules has been also discussed in FTAs. See *Internal USTR Paper on Monetary Fines*, Inside US Trade, Apr. 27, 2001, at 19-21.

⁴⁵³ See Davey, *supra* note 369, at 364; Davey, *supra* note 221, at 126. See also Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38. In establishing the *Iran – US Claims* tribunal, each government agreed any award to be enforceable against it in the courts of any nation. See Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran, art. IV. 3, Jan. 19, 1981, 20 I.L.M. 230 (1981).

⁴⁵⁴ See Davey, *supra* note 221, at 126.

partial settlement of any WTO dispute.⁴⁵⁵

In sum, the willingness of the parties to make monetary payments in international disputes along with the consideration of practical solutions suggested above would mean that the use of monetary payments in the WTO is feasible.

5.3. Implementation of Monetary Payment

As Davey suggests, the possibility of monetary payment should be available when parallel retaliation is not adequate.⁴⁵⁶ In other words, a requesting member that has been authorized to cross-retaliate would also have the option of receiving monetary payment. Hence, it would have the choice of remedy between the two.

While some WTO members have been reluctant to introduce monetary payments as an option because of the problem of disparity in the payment ability between developed and developing members, this strategy, in fact, avoids such a problem because it would usually be small country members that are authorized to cross-retaliate and, thus, would have the option of receiving monetary payment.⁴⁵⁷ Moreover, this strategy would effectively make small country members demand monetary payments without requiring the need for special and differential treatment to obtain the right to receive them.⁴⁵⁸

In addition, since the level of nullification or impairment has been already determined by the arbitration proceeding under Article 22.6 for the authorization of cross-retaliation,

⁴⁵⁵ See Trade Act of 2002, Pub. L. No. 107-210, § 5201, 116 Stat. 933, 1047. Interestingly, some have proposed that members may deposit a sum of money by posting a bond proportioned to the size of their economy. It would be posted in an escrow account so that it does not remain under the control of the member which posts it. See, e.g., Eleso, *supra* note 447, at 35-36.

⁴⁵⁶ See Davey, *supra* note 369, at 364.

⁴⁵⁷ In my view, the disparity in the ability to make monetary payment does not seem to be a real problem, since, as experience shows, members that have not complied with WTO obligations so far mostly happened to be developed members.

⁴⁵⁸ See Davey, *supra* note 369, at 364.

there would probably be no need to incur additional cost to determine the level of monetary payment.

As proposed with regard to retaliation, the retroactive determination of the level of monetary payment should be introduced. This would not only redress past injuries to some degree, but also create incentives for prompt compliance and discourage delay.⁴⁵⁹ No matter when the starting point of retroactive determination would be, it should be determined in the same way as the level of retaliation.

In sum, the introduction of a monetary payment as a remedy would provide benefits to the complaining member that is unable to gain benefits from retaliation. Of course, monetary payment appears to be already available in the WTO at the stage of compensation, which is a mutually agreed solution by the members to a dispute. However, such solutions often break down, and thereby undesirable retaliation remains the only remedy. Thus, it would be desirable to provide monetary payment at the stage of retaliation as an alternative remedy, when a complaining member finds that this is better able to achieve compliance or is in line with its interests. It is not a replacement for retaliation but an additional choice for the complaining member. If the violating member does not make a monetary payment, there is always the fallback of retaliation as a last resort.⁴⁶⁰

⁴⁵⁹ In this regard, the African Group proposed the amendment of Article 21.8 of the DSU by adding the following: “[t]he quantification of injury and compensation shall be computed as from the date of the adoption of the measure found to be inconsistent with covered agreements until the date of its withdrawal.” See African Group Text, *supra* note 395, pt. VIII. The LDC Group also proposed in the same manner that “[t]he quantification of loss or injury to be compensated should always commence from the date the Member in breach adopted the offending measure.” See LDC Group Proposal, *supra* note 395, ¶ 13.

⁴⁶⁰ See Simmon J. Evenett, *Reforming WTO Retaliation: Any Lessons from Competition Law*, in *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* 641, 647 (Chad P. Bown & Joost Pauwelyn eds., 2010) (Arguing that “[e]ven if non-distortive sanctions can be applied (such as fines) one may need the credible threat of distortive trade sanctions to ensure the former are complied with”). Under the NAFTA and FTAs, the complaining party reserves its right to suspend concessions, if a violating party fails to pay monetary enforcement assessment. See, e.g., NAAEC art. 36; US-Chile FTA art. 22.15; US-

Perhaps, most importantly, it should be remembered that monetary payment is only a temporary remedy until the violation is removed. The violating member still has the obligation of bringing its measures into conformity with WTO obligations.

Having more diverse remedies may offer a greater chance of compliance in the WTO dispute settlement system. It seems to be expected that the introduction of a monetary payment would ultimately lead developing members to a more frequent use of the system.⁴⁶¹

II. More Extensive Use of Compensation

In this Section, I will consider whether it would be desirable to promote the more extensive use of the current system of compensation. From an economic standpoint, compensation is considered to be the preferred remedy over retaliation in the sense that it increases trade liberalization and economic welfare, at least temporarily, in both complaining and complained-against members.

Unfortunately, however, the use of compensation has been rather limited because of its voluntary nature and the application of MFN treatment. These constraints dissuade members from agreeing on mutually acceptable compensation.

In the following, I consider the possibilities of extending the use of compensation. I will discuss the more extensive use of trade compensation and of monetary compensation in separate sub-Sections.

Australia FTA art. 21.11.

⁴⁶¹ See generally Eleso, *supra* note 447.

1. Trade Compensation

Because of the limits of voluntary compensation, Ecuador has proposed compulsory compensation as a last resort with “the additional advantage of providing a new maximum reasonable period of six months during which the Member concerned must necessarily pay compensation.”⁴⁶² The LDC Group has also proposed that “compensation under Article 22.2 should be made mandatory by the elimination of the phrase ‘if so requested’ in that paragraph.”⁴⁶³

The idea of mandatory compensation is that a member that has prevailed in a dispute but is faced with non-compliance or the DSB could choose in which sectors the violating member should offer compensation.⁴⁶⁴ This seems, however, unrealistic because there are no ways to compel a member to provide compensation in any sector. “Just as the WTO has no power to compel compliance, it has no power to compel compensation.”⁴⁶⁵ Moreover, this may tarnish the very meaning of compensation, which is to negotiate seriously to find mutually agreed solutions, one of the objectives of WTO dispute settlement.

Moreover, the application of MFN treatment makes the use of compensation less attractive. It means that not only the complaining member, but also any other member

⁴⁶² Special Session of the Dispute Settlement Body, *Contribution of Ecuador to the Improvement of the Dispute Settlement Understanding of the WTO*, Communication from Ecuador, 5, TN/DS/W/9 (Jul. 8, 2002).

⁴⁶³ LDC Group Proposal, *supra* note 395, ¶ 13.

⁴⁶⁴ See Mercurio, *supra* note 444, at 325; Bronckers & Broek, *supra* note 440, at 107; Pauwelyn, *supra* note 228, at 345-346; Horlick, *supra* note 220, at 642. As another solution to elaborate the extensive use of compensation, Lawrence proposed that WTO members could pre-announce the sectors in which liberalization would take place, thus offering pre-authorized compensation, so-called contingent liberalization commitments (CLC). Therefore, in case of non-compliance, a member that prevailed in a dispute may choose an equivalent level of concessions from the CLC. This would “create domestic constituencies in each country that would lobby for compliance, motivated by the prospects of losing protection.” See Lawrence, *supra* note 318, at 86-89. However, this idea has not been progressed ever since.

⁴⁶⁵ Charnovitz, *supra* note 232, at 430. See also Allan Rosas, *Implementation and Enforcement of WTO Dispute Settlement Findings: An EU Perspective*, 4 J. Int’l Econ. L. 144 (2001).

exporting to the violating member, receives the benefits of compensation. In this regard, the violating member may be reluctant to provide compensation because it has to allow a level of market access that would be higher than the level of nullification or impairment suffered by the complaining member. Conversely, the complaining member may also be reluctant to agree on compensation because its benefits may be dispersed to other members exporting to the violating member when it can instead receive the full “benefits” of retaliation.⁴⁶⁶

However, as proposed earlier, if the level of retaliation is measured from an earlier point of time than the expiration of the reasonable period of time, the violating member would be more willing to provide compensation in part because the amount of compensation would be lower than the amount of retaliation. Thus, such a measure would encourage parties to a dispute to negotiate seriously for compensation as a mutually agreed, temporary solution.

Furthermore, in a case in which a complaining member cannot effectively retaliate, taking part of the benefit of MFN trade compensation would rather be an attractive option. At the stage of compensation, it is for the parties to a dispute to negotiate and choose the products whose tariffs are to be reduced, not the third members. In this sense, they could strategically agree on products for compensation that would confer the most benefits to the complaining member, thereby, to some degree, alleviating the disadvantages of MFN treatment.⁴⁶⁷

In sum, retroactive retaliation along with the strategic negotiation on products for

⁴⁶⁶ See Ch. 2. Sec. II. 5.2.2.

⁴⁶⁷ See Davies, *supra* note 210, at 38 & 43-44 (Arguing that “the value of trade temporarily created by trade compensation may be higher than the value of trade temporarily lost through suspension”). Interestingly, Hudec argues that, since compensation is a temporary measure, it could be granted in a discriminatory manner by excluding the application of MFN treatment so long as it induces compliance. See Hudec, *supra* note 22, at 391 n.39.

compensation could provide the parties to a dispute the possibility of more extensive use of trade compensation.

2. Monetary Compensation

The difference between monetary compensation and monetary payment, as proposed in the previous Section for an alternative to cross-retaliation, is that monetary compensation is negotiated by the parties to a dispute, whereas monetary payment is determined by the arbitration proceeding under Article 22.6 of the DSU.⁴⁶⁸

Like monetary payment, if members concerned desire to have an objective assessment on the level of compensation, the arbitration proceeding under Article 25 may be held as an alternative means of dispute settlement, as seen in *US – Copyright Act*. Otherwise, if the members prefer to have a non-binding opinion on its level, they may resort to the conciliation or mediation procedures under Article 5 of the DSU.

Here, again, the problem with monetary compensation is whether it should be administered in accordance with MFN treatment. Some argue that the negotiating history and the decisions of the Appellate Body clearly provide that any form of compensation must be compatible with MFN treatment.⁴⁶⁹ In this regard, the receipt of monetary compensation only by the EC in *US – Copyright Act* could be considered as an “advantage” that is not “accorded immediately and unconditionally” to all other WTO members within the meaning of Article I:1 of GATT and Article 4 of the TRIPS

⁴⁶⁸ See Ch. 4, Sec. I. 5.3.

⁴⁶⁹ See O’Connor & Djordjevic, *supra* note 84, at 132. See also Choi, *supra* note 364, at 1067; Mercurio, *supra* note 444, at 333.

Agreement. Australia raised this concern a number of times in the DSB meetings that such arrangements were apparently applied on a discriminatory basis.⁴⁷⁰

However, in my view, it is questionable whether the payment of monetary compensation confers an “advantage, favour, privilege or immunity” within the meaning of MFN treatment. Under Article I:1 of GATT, “advantage, favour, privilege or immunity” refers to “custom duties and charges,” the “international transfer of payments” or “rules and formalities” imposed relating to importation or exportation. The payment of monetary compensation does not fall under any of these criteria. It is neither a custom duty nor a rule in connection with importation or exportation that distorts the trading position of third members.⁴⁷¹ Moreover, in practice, the majority of WTO members did not object to the allegedly discriminatory nature of monetary compensation. Although Australia has continuously argued that monetary compensation has to be compatible with MFN treatment, it has not pressed its claim in a dispute settlement proceeding.⁴⁷²

Thus, in my view, monetary compensation does not have to be administered in accordance with MFN treatment, and this seems to be an obvious reason for distinguishing monetary compensation from trade compensation.

In sum, the inapplicability of MFN treatment along with retroactive retaliation could provide the violating member with the possibility of more extensive use of monetary

⁴⁷⁰ See, e.g., Dispute Settlement Body, *Minutes of Meeting, Held in the Centre William Rappard on 24 June 2002*, ¶ 5, TN/DSB/M/128 (Aug. 20, 2002); Dispute Settlement Body, *Minutes of Meeting, Held in the Centre William Rappard on 17 April 2002*, ¶ 5, TN/DSB/M/123 (May 6, 2002).

⁴⁷¹ See generally Bronckers & Broek, *supra* note 440, at 119; Sherzod Shadikhodjaev & Nohyoung Park, *Cessation and Reparation in the GATT/WTO Legal System: A View from the Law of State Responsibility*, 41 J. World Trade 1237, 1255-1256 (2007).

⁴⁷² See Shadikhodjaev, *supra* note 304, at 25. Interestingly, some argue that the payment of monetary compensation could constitute as an illegal subsidy. See Mercurio, *supra* note 444, at 333; Choi, *supra* note 364, at 1067. However, this argument seems unconvincing in the sense that it is only paid up to or below the level of nullification or impairment which does not consider the requirement of the existence of subsidy under the SCM Agreement. And, it is not quite sure whether it will be transferred directly to a particular private entity such that it may constitute a subsidy.

compensation.

III. Conclusion

In this Chapter, I attempted to provide some possible improvements to the remedies available through the WTO dispute settlement system. In doing so, I proposed remedies in consideration of accomplishing their ultimate purpose, inducing compliance, along with an idea of solving the problems that they are facing currently.

In Section I, I focused on the improvement of the current system of retaliation. First, I proposed retroactive retaliation in order to create incentives for prompt compliance and discourage delay. In detail, as the DSB calls for “prompt compliance,” I argued that the level of retaliation should, at a minimum, be calculated as commencing as of the date of the adoption of the panel or Appellate Body reports. This may provide a strong incentive for the violating member to comply soon after such reports have been adopted.

Second, I proposed some changes to the method of implementation of the retaliatory measures: the rotation of products on retaliation lists and gradual changes to the level of retaliation over time. The products on a retaliation list could be rotated periodically to give more impact on the violating member thereby affecting many exporting industries that may provide more opportunities to press their government for compliance. Such rotation seems to be legitimate as long as the level of retaliation does not exceed the level of nullification or impairment and is authorized by the DSB. The gradual change of the level of retaliation, in the form of incremental or partial implementation, would also create more incentives for compliance than the full level of retaliation. Such changes would be more powerful in the sense that frustrated exporters are able to exert more

pressure on their government and thereby become irritants than those eliminated exporters who have entirely lost their markets without any hope for reclaiming it.

Third, there is a possibility of introducing collective retaliation in limited circumstances. As long as the standard of equivalence is ensured, multiple complainants in the same dispute may collectively retaliate against the violating member by sharing the total level of retaliation in proportion to their retaliation capacity. This strategy would not only indirectly provide small country complainants effective retaliation, but also create more opportunity to inflict sufficient harm on the most politically powerful exporters in the violating member to lobby their government for compliance.

Fourth, I proposed monetary payment as an alternative remedy to retaliation. In its implementation, it should be made available to a member that has been authorized to cross-retaliate. This strategy would, in fact, avoid the problem of disparity in the payment ability between developed and developing members. The introduction of monetary payment is to provide benefits to the complaining member that is unable to gain benefits from retaliation. It is to provide an additional option for the complaining member when it finds that this is better to achieve compliance or in line with its interests. If the violating member does not make monetary payment, there is always the fallback of retaliation as a last resort. It should be remembered, however, that monetary payment is only a temporary remedy until the violation is removed. Thus, the violating member still has the obligation of bringing its measures into conformity with WTO obligations.

In addition, I stressed the importance of the impact and effectiveness of TRIPS retaliation. Retaliation on TRIPS obligations is of significant value for a developing member in a dispute with a developed member. It solves the problem of imbalance in the

compliance enforcement capacity and provides sufficient pressure on the violating member for compliance. The most important consideration of TRIPS retaliation is that it should be implemented only in the domestic market of the retaliating member and not exported to other members. As seen in *EC – Bananas*, one solution would be to install a government-controlled system that would trace the products violating TRIPS requirements to ensure they are sold only in the domestic market.

In Section II, I considered the more extensive use of the current system of compensation. I emphasized that compensation is a preferable remedy to retaliation. In case of trade compensation, retroactive retaliation along with the strategic negotiation on products for compensation could provide the parties to a dispute with the possibility of its more extensive use. In the case of monetary compensation, the inapplicability of MFN treatment along with retroactive retaliation could also provide the violating member with an incentive to use it more extensively.

Besides the possible improvements of retaliation and compensation, improvement of the dispute settlement procedures could also be considered in order to solve the problem of non-compliance. First, a number of WTO members have proposed to determine the level of nullification or impairment at an early stage. Korea proposed that, if the level of nullification or impairment could be determined at the stage of compliance review under Article 21.5 of the DSU, it would facilitate the implementation of WTO recommendations without reference to an arbitration proceeding under Article 22.6. It further argued that if the level of nullification or impairment has been determined before the expiration of the reasonable period of time, it would provide strong incentives for

compliance and, substantially, facilitate the negotiation for compensation.⁴⁷³ Subsequently, Mexico has also proposed to “incorporate” the procedure under Article 22.7 into the original panel process. The arbitration proceedings could then start after the interim panel report has been issued and determine the level of nullification or impairment based on the panel’s interim findings and conclusions, which could be reviewed by the Appellate Body. The DSB could then authorize retaliation upon adoption of the panel or Appellate Body reports. In Mexico’s view, this would create incentives for prompt compliance, satisfactory solutions and time saving.⁴⁷⁴ However, in my view, the early determination of the level of nullification or impairment seems to disregard the member’s right to a reasonable period of time.⁴⁷⁵ Moreover, given the overall successful compliance record in WTO dispute settlement, it would be time-consuming and costly to determine the level of nullification or impairment, for example, in the panel process, since few cases ultimately require such a determination.

Second, specifying binding suggestions for implementing DSB recommendations could be considered. Generally, when the measure concerned has been found in violation of WTO obligations, a panel or the Appellate Body simply recommends nothing more than bringing the measure into conformity with its ruling. Of course, it may make suggestions about specific ways to achieve compliance. Yet, the violating members usually oppose such suggestions, which seem to be non-binding on the parties of a dispute, and prefer their own ways of bringing compliance. Moreover, although compliance review is available under Article 21.5 and the violating member has to submit

⁴⁷³ See Special Session of the Dispute Settlement Body, *Contribution of the Republic of Korea to the Improvement of the Dispute Settlement Understanding of the WTO, Communication from the Republic of Korea*, TN/DS/W/11 (Jul. 11, 2002).

⁴⁷⁴ See Mexican Proposal, *supra* note 366, at 2-3.

⁴⁷⁵ See Special Session of the Dispute Settlement Body, *Minutes of Meeting, Held in the Centre William Rappard on 16 – 18 December 2002*, ¶ 20, TN/DS/M/7 (Jun. 26, 2003).

status reports to the DSB under Article 22.6, there is no requirement for it to specify the measure it intends to use for compliance. Thus, the way of achieving compliance is entirely left to the discretion of the violating member thereby, often, resulting in procedural delays and inadequate implementation.⁴⁷⁶ Therefore, one solution would be for a panel and the Appellate Body to specify binding suggestions for implementing their recommendations. The use of specific suggestions would help arbitrators readily determine whether the recommendations have been implemented. Furthermore, this would particularly be beneficial to small developing members that have an insufficient ability of monitoring compliance.⁴⁷⁷ In addition, in terms of monitoring compliance, opening DSB meetings to the public would create greater transparency to increase public awareness of non-compliance. The violating member may feel strong pressure by the public's awareness of its non-compliance and, ultimately, be shamed into compliance.⁴⁷⁸

⁴⁷⁶ See Carolyn B. Gleason & Pamela D. Walther, *The WTO Dispute Settlement Implementation Procedure: A System in Need of Reform*, 31 Law & Pol'y Int'l Bus. 709, 714-721 (2000).

⁴⁷⁷ See Broek, *supra* note 37, at 158.

⁴⁷⁸ See Sayera J. Iqbal Qasim, *Collective Action in the WTO: A "Developing" Movement toward Free Trade*, 39 U. Mem. L. Rev. 153, 173-174 (2008); W. Michael Reisman, *Sanctions and Enforcement*, in *International Law Essays: A Supplement to International Law in Contemporary Perspective* 381, 419 (Myres S. McDougal & W. Michael Reisman eds., 1981).

CHAPTER 5: CONCLUSION

This dissertation attempts to examine the problems of WTO dispute settlement remedies and consider possible improvements to them. It is generally a study of how to improve compliance in WTO dispute settlement. In Chapter 2, I discussed the applicable rules and procedures of WTO dispute settlement remedies in order to provide a general understanding of this dissertation and examined the current problems of that system. In Chapter 3, I explored the purpose of WTO dispute settlement remedies as an essential prerequisite for designing effective remedies. In this examination, I determined that WTO remedies serve as deterrent instruments preventing non-compliance with WTO obligations and future cases of nullification or impairment. Thus, the ultimate purpose of remedies is to induce compliance, while some form of compensation may be provided and trade balance may be restored temporarily until compliance is achieved. In Chapter 4, I provided some possible improvements to WTO dispute settlement remedies in accordance with their purpose and in a way to solve their current problems. Here, the essential point is that it would be appropriate to consider these proposed improvements as one set of instruments rather than as distinct options. By and large, they would likely contribute to building effective remedies and improving compliance, in terms of quality and timeliness, in the WTO dispute settlement system.

Given the present trends towards globalization, states are willing to hand over their part of sovereignty for benefits received from international cooperation. And, a strong multilateral system is needed to promote such cooperation that may correspond to the imperatives of global governance.

The WTO is considered as a strong multilateral trading system. In particular, its dispute settlement system, which is governed under the DSU, has brought significant improvement in the sense that it provides good quality and adequately reasoned decisions in dealing with disputes, thereby enshrining the rule of law in international trade relations. However, in order to be an effective dispute settlement system, it must not merely generate rules or decisions, but also provide an effective means of settling disputes.⁴⁷⁹ With the improvement and reform of WTO dispute settlement remedies, the WTO will take a progressive step towards becoming a more effective dispute settlement system. Thus, steady efforts should be made for the study on the improvement of WTO dispute settlement remedies in order to ensure effective compliance and, ultimately, the stability and credibility of the world trading economy.

While the interpretation of WTO rules is the responsibility of a panel or the Appellate Body, the application and legislation of such rules are the responsibility of the member states. Therefore, as long as the WTO remains an attractive venue for settling international trade disputes, it is the responsibility of the member states' governments to prevent violations and serve as guardians for the system.

⁴⁷⁹ See J. G. Merrills, *International Dispute Settlement* 233 (4th ed. 2005).

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